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# Management Control System: Theoretical and Realistic Literature Assessment

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***Abstract***

*The effort of this part is to assess the status of the hypothetical and sensible text pertaining to the study of organization control systems. More than the preceding four decades, the MCS literature has been subjugated by the eventuality paradigm, the incessant redefinition of what constitutes an 'MCS, and the quantitative-led implications and findings that remain allied to the role of relative factors in MCS design and use.*

*Even though the academic and abstract underpinnings (and consequent methods) have now become more assorted, it leftovers relatable to present this chapter vis-à-vis this prevailing paradigm and the synchronized methodologies. This chapter also seeks to exhibit the comparative scarcity of study on the pragmatic implications of administrative dysfunctional behaviours as a consequence of MCS.*

## The Contingency Model in Administration Secretarial and Control Systems

Contingency theory asserts that organizations structure and design their management accounting and control systems (MACS) in relation to a set of external and internal contingent factors, in a bid to maximize managerial performance and effectiveness. Examples of such factors would be the level of technology and environmental uncertainty faced by the respective organizations.

## Early "Contingency-Implicit" Studies

Burns and Stalker (1961), Woodward (1965), Hopwood (1972) and Khandwalla (1972) are examples of studies where contingent factors and MACS design were intuitively linked to explain seemingly contradictory results. In fact, Hopwoods' (1972) results on the budget constrained style vs. profit constrained style sparked an

important development in the contingency theory formulation when they were compared to the results of Otley (1978). The latter used measures comparable to Hopwood's (1972) study and found that:

"Hopwood's results were driven by the technical inadequacies of the accounting system as a means of performance evaluation in the interdependent cost centers."

This refers to Otley's (1980, p. 86) earlier statement of "An important situational difference which is suggestive of a contingent explanation". Similar evidence of such situational difference is found in Khandwalla (1972), where the sophistication of accounting and control systems was related to the intensity of competition the organization faced. The environment was thus considered as an important factor in explaining managers' use of the information provided by the accounting and control system.

The relevance of organizational structure within a contingency paradigm was eventually applied and tested in various studies such as Lawrence and Lorsch (1967), Bruns and Waterhouse (1975), Sathe (1978), Watson and Baumler (1975), and Waterhouse and Tiessen (1978). As mentioned earlier, the conceptualization of a contingency theory for MCS design might have been a lesser priority at that time.

**Issues in Selecting Incident Variables**

The need of communication could also be associated to the assortment (or non selection) of contingency variables. In the context of MCS studies, there has been little work in the detection of pertinent contingency variables whereby:

"A reliant variable is appropriate to the extent that businesses that differ on that variable also demonstrate major differences in how control attributes or measures are linked with performance". (Fisher, 1998, p. 48)

This created the perception that contingency studies have come to be seen as large scale, cross sectional, postal questionnaire-based research, which examine the interaction of a limited number of variables. Within the same context, it should be reminded that contingency theorists already warned of the inability of the study to provide generally applicable results, but only locally accurate ones. The treatment of strategy as a variable in contingency studies highlights the problem of a "trade

off" between the three qualities of contingency-based research: simplicity, generality and accuracy. Such a trade-off may be viewed as necessary to analyze the results of "strategy-based" studies but it may also inherently impede the development of an overall contingency framework. The lack of a substantive basis to suggest which variables, and/or which combinations of variables, is important. It may be true that there are very strong, empirically validated, relationships for variables such as environmental uncertainty, technology and strategy but this does not necessarily mean they are the most important ones. Indeed, the authors make a very pertinent observation which illustrates the paradox of the contingency paradigm that is difficult to argue against inclusion of any of the contingent variables, yet equally difficult to determine their completeness or to know which combinations of factors make sense and are more important.

## Comparing the Definitions and Conceptualizations of MCS

MCS is referred to as a formal (cybernetic) control system with an overall aim of regulating behaviours within the organization. So far, research in MCS has been restricted to the relationships between managers and their superiors, and thus does not consider the effects/consequences/effectiveness of control systems on non-managerial staff. Hence, Merchant's (1989) definition (cited in Fisher, 1995) is more relevant i.e. MCS aims at ensuring that mid-level managers carry out organizational objectives and strategies. In contrast to Shields et al.'s (2000, p. 185) traditional view of the cybernetic control model where targets (budget or standards) are compared to actual output as a basis for corrective action or performance evaluation, Anthony and Govindarajan (1998, p. 7) contend that management control must take a more flexible perspective and would, in fact, involve all managerial activities. This has allowed for a gradual inclusion of non-financial based measures/controls e.g. Abernethy and Lillis (1995), Fisher (1995 and 1996), Chow et al. (1996), Langfield-Smith (1997), Anthony and Govindarajan (1998) and Davila (2000)19. Chenhall (2003, p. 129) made a more recent attempt at defining MCS but argued that MCS is a broader term that encompasses MAS and also includes other controls such as personal or clan controls, and perceives MCS as "passive tools" providing information to assist managers. This is in contrast to Anthony and Govindarajan's

(1998) perspective since they consider MCS to be an "active tool" for managerial activities.

In parallel, Simons (1995; 2000) reviews the conceptualization of control systems in the context of strategy implementation. He argues that MCS are in fact information-based systems that 'become' control systems when they are used to maintain or alter patterns in organizational activities (1995, p. 5). To some extent, he sought to transcend the various previously used distinctions – i.e. active/passive, formal/informal and financial/non-financial – and posits that the control of business strategy is achieved by the combined use and integration of four levers of control, namely belief systems, boundary systems, diagnostic control systems and interactive control systems. More crucially however, he argues that the power of these levers in implementing strategy does not lie in how each is used alone, but rather in how the forces create a 'dynamic tension' (Simons, 2000, p. 301). As a result of this dynamic tension, it is argued that control features can be complementary i.e. increasing the emphasis on one control component increases the benefit received from other control components (Tuomela, 2005; Widener, 2007). However, the focus of Simon's conceptualizations of controls is more generic, focusing more on strategy-controls linkages and how these are collectively used rather than on the nature, feature or characteristics of management controls and how they each individually influence behaviour.

Nevertheless, and based on the above-mentioned definitions, it can be stated that MCS research tends to focus on the control aspects of an organization's management information system.

## Categories of Control Systems

The literature provides different categories and types of management control systems. Westerlund and Sjostrand (1979, cited in Otley, 1980) classify formalized control systems as "means of control" for long-range or short-range activity. Examples of some of the means of control for short-range activity are regulations, budgets, directions, checklists, standards, resource allocation and delegation of decisions. The long-range activity "means of controls" are mostly in the form of long term planning documents (for investment, recruitment and selection and promotions).

An alternative categorization of control practices was also proposed by Merchant

(1982), where he classified control mechanisms as (i) specific-action controls, (ii) results-of-decisions controls and (iii) personnel controls. The first category focused on authority-limit controls (e.g. authority limits, standard procedures and manuals) while the second category considered the extent of formal meetings to review decisions and required explanations for variances. Finally, personnel controls related to the extent of use of informal contacts meetings with superiors and the use of belief/boundary systems.

As explained in the previous section, Simons (1995; 2001) developed a generic and broader conceptualization of control systems by referring to belief systems (used to inspire and direct the search for new opportunities), boundary systems (used to set limits on opportunity seeking behaviour), diagnostic controls (used to motivate, monitor, and reward achievement of specified goals), and interactive controls (used to stimulate organizational learning, and the emergence of new ideas and strategies). There is a fourth category, known as information system controls, which relates to informational characteristics rather than control ones. Systems create positive and inspirational forces; the other two levers create constraints and ensure compliance with orders. It is this interplay of forces – operated by senior managers – that creates a dynamic tension. On the other hand, Fisher (1995) refers to Giglioni and Bedeian's21 (1974) distinction between general control mechanisms and formal control systems. The former is applied via standard operating procedures, firm structure, firm culture and human resource policies whereas the latter category must be based on performance targets, actual and feedback. The general control mechanisms are not formal control systems, but they do impact on the operation and effectiveness of formal control systems. While general control mechanisms, such as firm culture and firm structure, can indeed be viewed as being indirectly related to an organization's control system, it is difficult to consider standard operating procedures (SOP) as being potentially less important than other formal control systems such as a budgetary control system.

**Environmental Ambiguity, Market Factors and Volatility**

Evidence on the moderating impact of the "environment" was already implicit (via functional areas) in Brownell's (1985)

findings. Merchant (1984) also looked at the effect of market factors (measured via Product Life Cycle and Market Position) on the participation-performance relationship. It was hypothesized that departments involve with mature/declining products and those being in a strong market position (market leader) would exhibit higher participation-performance correlations compared to emerging/growth-products and weak-market position departments.

The study obtained 77 responses (84%) from heads of departments, with half from the production area. Their immediate supervisors also provided data on the subordinate's performance and level of environmental uncertainty relative to the subordinate's department. In contrast to previous studies examining the influence of environmental factors, the results indicate a positive interaction environmental uncertainty on the participation performance (and attitude) relationship, thus demonstrating the relevance of environmental uncertainty. In addition, the performance measure was more reliable as superiors were asked to rate their subordinate's performance. In addition, the prominence of the production/operations/R&D functional areas (61% of respondents) could have influenced the level of uncertainty.

**National Culture**

Further to the findings on cultural dimensions, there has been some investigation into the influence of cultural attributes in the effectiveness of participative budgeting. Two of these four cultural dimensions, namely power distance (the extent to which society accepts inequalities and does not challenge hierarchies i.e. high PD) and individualism (the relationship between an individual and his/her fellow individuals in society), are of direct relevance to budgetary participation. Participation did not affect motivation in high power distance countries compared to low power distance countries. A subordinate's participation in target/budget setting is deemed to be a "culturally awkward" practice in high PD countries and thus would not have any bearing on motivation. Insofar as individualism is concerned, participative budgeting would be more effective in a low individualism setting because the participation process implies an attempt at collective agreement whereas participation in a high individualism society (e.g. USA) would only reveal irreconcilable

differences between the various people involved in the process.

Thus, for organizations with a high (low) power distance culture, it is expected that budget participation will result in increased (decreased) role ambiguity and decreased (increased) trust and respect for the superior.

Based on a sample of 125 managers, the study found mixed results for participation ambiguity relationship. The study also used two different measures of participation (Milani, 1975 and Hofstede, 1968) to obtain some cross-validation (1995, p. 389) but the interaction term was not found to be significant for Milani's instrument. The other two dimensions are uncertainty avoidance and masculinity.

**Job Difficulty**

We can explore the possible relevance of task uncertainty by using the term "job difficulty", which is a sub-dimension of task uncertainty. A job is difficult because of its complexity, heterogeneity, unpredictability or because of its changing operational technology. In a high job difficulty situation, a high level of budgetary participation will provide opportunities for exchange of information and such interaction would be expected to generate better performance and higher motivation. On the other hand, a mismatch between job difficulty and participation is predicted to result into lower outcome for the above-mentioned dependent variables.

**Reliance on Accounting Performance Measures (RAPM)**

**Reliance on Accounting Performance Measures** is another key area of management accounting research, which seeks to investigate the effects of - and the factors influencing - the use of accounting data (namely budgets) for evaluating managerial performance. More formally, Harrison (1993, p. 319) considers Reliance on Accounting Performance Measures to be:

"The extent to which superiors rely on, and emphasize those performance criteria which are quantified in accounting and financial terms, and which are pre-specified as budget targets"

**Superiors' Use of Controls: Interactive and Diagnostic Use**

The selection and development of this contextual variable has stemmed from various strands of the MCS literature. Firstly, at the core of the argument, there is the (limited) research on the extent of the

relationship between the supervisor and the subordinate Originates from initial research on EU (e.g. Duncan, 1972; Khandwalla, 1972, Burns and Stalker, 1961) Originates from initial research on technology (e.g. Woodward, 1965; Perrow, 1970, Thompson, 1967) 55 It would be safe to argue that a significant number of companies do not solely engage in mass production or custom-made production but rather a combination of both 56 Although these distinctions are easy to grasp from a manufacturing perspective, there is theoretically no

difference in applying such concepts in a services industry (e.g. banks, insurance and hotels, etc)93 manager which has so far focused on variables such as leadership style, trust, and information asymmetry (e.g. refer to Hartmann, 2000, p. 464). Intuitively, how far managers would be reacting (negatively or positively) to specific control systems could be dependent on how they perceived their supervisors to be using those controls. Hence, rather than focusing on a "vague" variable such as leadership style, it would be the supervisor's style of using the MCS which could be relevant.