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# Role of Management Control Systems in Implementing Strategic Change

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**ABSTRACT**

A *control system is necessary in any organization in which the activities of different divisions, departments, sections, and so on need to be coordinated and controlled. This paper is an attempt to undertake the importance of the Management Control System in the today's world. Management Control System is a level refers to the middle level managers includes regional managers, productive directors and division heads. This study emphasized that how a control system is necessary in any organization in which the activities of a company's department directors also may benefit from the organization provided by management control systems. Directors often are responsible for coordinating activities with human resources to create employee incentives and to hire upper-level managers. Under a management control system, directors can better analyze production progress, provide appropriate job assignments and more effectively communicate with all company employees. Measuring performance also is an important component of management control systems. Directors and upper-level managers generally aim to provide fair and effective employee evaluations. Control systems help reviewers develop performance evaluations that provide useful and encouraging employee insight and accurate productivity analysis; these evaluations may even be used as an opportunity to provide performance-based incentives. This study also focused on the role of management control systems in implementing strategic change.*

**Keywords**: Management Control System, Department, Organization, Managers.

## 1. Introduction

In business organizations management control systems play a pivotal role, as they serve as an instrument to survive in an uncertain environment. Otley argues that in a climate of continuous change management is forced to adapt itself constantly, which requires the active involvement of a larger number of organizational participants. This means that there is a need for the empowerment of the lower levels of the organization. In this context, MCS can be used as a control tool by work groups on all levels. Empowerment means giving the lower levels in the organization both authority and responsibility, so middle-level managers are encouraged to take whatever action is necessary to achieve the organizational goals. This study investigates how managers use the management control systems as levers of strategic change. This question is interesting both in theoretical and practical viewpoints. Firms operate in an increasingly turbulent environment caused by technological, social, political, and ethical change. Otley (1994) called for studying management of change which relates to methods of planning and developing flexibility to cope with change.

Management Control is a must in any organization that practices decentralization. One view argues that management control systems must fit the firm's strategy. This implies the strategy is first developed through a formal and rational process, and this strategy then dictates the design of the firm's management system. On the other hand, we can say that, management control systems can impact the development of strategies. When firms operate in industry contexts where environmental changes are predictable, they can use a formal and rational process to develop the strategy first and then design management control systems to execute that strategy. However, in a rapidly changing environment, it is difficult for a firm to formulate the strategy first and then design management systems to execute the chosen strategy (Anthony and Govindarajan, 2004).

Earlier research on the role of management control systems in implementing strategic change pays little attention on *how* management control systems are used in organization undergoing strategic changes (Abernethy, 1999; Shields, 1997; Langfield-Smith, 1997). It is interesting to study how change occurs, who initiates it, what constrains it, and which mechanisms should be used to facilitate it (Kelly & Amburgey, 1991).

This paper develops two main new ideas: firstly, that the framework of analysis of management control system should not be limited to the use of control system and the compensation system, but could be extended to cover two other elements: the organizational structure and the management tool; secondly, it explores how all four elements interact in practice. Such an interaction introduces a balanced approach combining both interactive and diagnostic features as another important benchmark. We explore the extent to which managers believe their management control systems are employed when implementing planned change. Relationships between commonly employed management controls and implementation success are also estimated. In some cases, managers used management control systems less extensively than other elements of change process, although usage of control systems increased with implementation. A strong relationship was found between the use of control systems based on outcomes monitoring and implementation success. However, there was no significant relationship between the use of behavior-based controls and implementation success. Overall, the findings suggest that many organizations may underutilize formal controls, particularly those related to outcomes monitoring, when managing change.

Many of the research efforts, so far have been directed towards the importance of management control systems and its uses in an organizational workplace. Although, many studies have been conducted individually to ascertain the uses of management control systems and also determine the main causes and their consequences on the workplace, which affecting the control systems. This study is an effort to understand the conceptual framework of management control system including strategic planning and their uses.

## 2. Literature Review

Tanguy (1989) carried out a study to provide another way of management control use in strategic change. It concerns a strategic turnaround in a company operating in the Champagne sector. The company faced difficult coordination problems due to major uncertainties concerning both its outputs and its inputs. The new CEO triggered the creation of a customized tool. This tool facilitates the elaboration of strategies that would be both feasible (*i.e.* it would allow to bypass the climatic variability and be consistent with the regulatory constraints of the Champagne sector) and profitable. However he did not directly participate in the discussion with his subordinates, in particular as long as feasibility was concerned. His implication focused on the profitability of the proposed feasible strategies. The face-to-face meetings – to elaborate the feasible strategies - were only organized among cross-functional teams.

Simons (1995, 2000) in his book entitled "Levers of control" conducted a study for a diagnostic use of control system, the main actors are the gatekeepers (like accountants, sales planners, engineers, and quality control expert management controllers), who are in charge to focus the attention of the line managers on the negative variances; and for an interactive use, the main actors are operational managers (down to three or four levels in the organization). Although he also stressed the important roles the middle managers, he did not much indicate the patterns of motivation and behavior necessary for middle managers to fulfill these expectations.

The Tuomela (2005)'s case FinABB presents the interplay between interactive and diagnostic control. The *3K Scorecard*, a customized tool, was used interactively at top management's level, but diagnostically at lower levels. The diagnostic control enables to clarify the goals, strategies and relevant key success factors, while the interactive control allows learning about all of them and searching for the ways to implement them. The roles that the business controllers played, either as a reporting accountant or coordination, are dependent on the willingness of operational managers.

While Simons' case study focused on studying top management level, Tanguy and Tuomela extended their research to lower levels. Simons argued that in the context of strategic change, one interactive control system is only used after diagnostic control systems. And the vertical coordination between the top manager and the subordinates is dominant, while neither the issue of horizontal coordination nor the need for a customized tool is mentioned.

Tuomela' case study illustrated the possibility to use the same customized tool interactively at top management level, and diagnostically at lower level. Whereas Tanguy's case study gave an inverse example: interactively at lower level and moderately at top management. Both researchers emphasized the essential roles of horizontal coordination and customized tools. The roles of management controllers, in both cases, are reinforced as the main coordinators, not as scorekeepers.

Rosanas and Velilla (2005) carried out a study to examine the conventional analyses of management control systems, to conclude, first, that the "illusion of control" can mislead managers into believing that everything can be controlled and monitored, and, second, that no incentive system based only on extrinsic rewards can motivate individuals properly. This study also investigates the philosophical foundations of the basic assumptions that, implicitly or explicitly, are made about the nature of the acting person.

Henri (2006) argued that a balanced use of both diagnostic and interactive control systems allows amplifying the positive effects of both systems while reducing their negative effects. The key issue is to create a balanced use. What is the nature of such a use? The actual researches, in particular three above-mentioned case studies, have not yet provided the response. This will be one of our research objectives.

Thiry & Deguire (2007), consists of 1) strategic governance and coordination (i.e. interpreting strategy and offering the means to reformulate, update, and implement strategy), and 2) administrative governance (i.e. collecting data, optimizing efforts, setting standards and procedures, consulting, training). The actual researches on interface actors emphasize on their administrative functions and mostly ignore their functions relating to the strategic governance and coordination.

Above review of the earlier studies, on the importance of management control system and their uses in the organizational workplace including strategic planning brings to the gape distinguishes the present work so far done. The pertinent literature scanned here in the form of books and articles, it relates to providing the remedial measures to take corrective action to improve the profitability and affectability of the organization. The scope of the study comprises an examination of management control systems and their effects on strategic formation at all the levels of management. The study also emphasized that how management control systems is effective for employees and is beneficial for better job performance and the challenging attitude of the employees for maximizing the productivity of the organization.

## 3. Objectives of the Study

The main objectives of this study are as under-

1. To ascertain the importance of management control system (MCS), and their causes and consequences which affecting the efficiency and affectability of the organization.
2. To evaluate MCS including strategic planning and its effectiveness on the employees as well as on the organizations.

## 4. Methodology

The study uses secondary sources for collecting facts and figures relating to the topic under this paper. Secondary data includes previously published pertinent literature, books, articles, periodicals and specialized journals. Such information provides the basis for building up the theoretical and conceptual framework of the study.

## 5. Definition of Management Control System

What constitutes a Management Control Systems (MCS) is a question that has been answered in various ways in the existing management accounting literature (Fisher, 1998; Malmi & Brown, 2008; Merchant & Otley, 2007). Due to the absence of a general and well articulated definition, the interpretation of research results and design of MCS is somewhat problematic (Fisher, 1998; Malmi & Brown, 2008). This view is supported by Bisbe (2007) who argue that it is important to pay particular attention to the conceptual specification of the studied construct since a careful definition will foster both more effective research into MCS and progress in understanding the results.

The earliest definition of MCS was provided by Anthony (1965), according to whom management control is "the process by which managers ensure that resources are obtained and used effectively and efficiently in the accomplishment of the organisation's objectives".

Anthony's (1965) definition is of slightly narrow nature since it separates management control from strategic control and operational control. Flamholtz (1983), on the other hand, emphasizes the behavioural aspect of MCS by arguing that individuals and organisations share only partially congruent objectives why it is necessary to channel human efforts toward a specified set of institutional goals, which inevitably leads to a need for control. The behavioural viewpoint is also supported by Merchant & Van der Stede (2003, p. 7) who argue that "...management control involves managers taking steps to ensure that the employees do what is best for the organisation. This is an important function because it is people in the organisation who make things happen…If all employees could always be relied on to do what is best for the organisation there would be no need for MCS". In addition-

Malmi and Brown (2008, p.290) have defined MCS as" those systems, rules, practices, values and other activities management put in place in order to direct employee behavior". They continue that these should be complete systems, not only simple rules. It is also mentioned to be important that the use of MCS is monitored.

In aggregate, Malmi & Brown (2008, p. 290) define MCS as follows:

*"Management controls include all the devices and systems managers use to ensure that the behaviours and decisions of their employees are consistent with the organization's objectives and strategies, but exclude pure decision-support systems. Any system, such as budgeting or a strategy scorecard can be categorised as a management control system."*

## 6. Nature of Management Control Systems

Flamholtz (1996) all organizations (businesses, universities, governments and hospitals) are concerned with channeling human efforts towards attainment of organizational objectives. Regardless of their formal purposes, organizations are composed of people with their own personal interests. Even if these individuals and groups wish to help attain organizational goals, the organization of which they are a part must coordinate their efforts and direct them toward specific goals. Thus organization must influence and control the behavior of employees, if they are to fulfill their plans and achieve their goals. To help gain control over the behavior of people in formal organizations, most enterprises use a combination of techniques including personal supervision, rules, standard operating procedures, job descriptions, budgets, accounting measurements and performance appraisal systems. Taken together, these techniques are part of an invisible yet very real system.

Management Control System plays a vital role in the management of an enterprise, but unlike machines, equipments, finances, and people its role is always hidden from view. When we examined an organization’s structure. Thus management control and management control systems are ubiquitous but difficult to visualize, they are pervasive yet lenuous; they are invisible, but have a significant impact on employee’s behavior.

## 7. Role of Management Control System in an Organization

The role of management control systems has always been considered to be that of changing the behavior of the individuals working in an organization by attempting to align the interests of the individuals with the interests of the organization. One essential element of the management control process is a formal system of: (1) goal-setting; (2) performance measurement and evaluation; (3) incentives. There seems to be broad agreement that the basic criterion for evaluating a management control system is that of 'goal congruence.' In a classic textbook formulation:

“In a goal congruent process, the actions people are led to take in accordance with their perceived self interest are also in the best interest of the organization" (Anthony and Govindarajan, 2003, p. 93).”

The measurement of the performance of business and any other organizations has long been of central interest to both managers and management accounting researchers. However, management accounting has tended to restrict itself to considering only financial performance, and to use frameworks and theories drawn primarily from the discipline of economics. The intention of this paper is to provide a perspective more focused on the operation of overall control systems, and to do so by looking beyond the *measurement* of performance to the *management* of performance. The most important distinction between performance and management control is that many task control systems are scientific, whereas management control never be reduced to a science. By definition, management control involves the behavior of managers, and this cannot be expressed by equation. In management control, managers interact with other managers; in performance control, either human being are not involved at all (as in some automated production processes), or the interaction is between a manager and a nonmanager.

## 8. Management Control systems and Employees

We have argued above that the basic purpose of any control system is to obtain behavior - a set of actions? On the part of employees that is congruent with organizational goals. Therefore, it is intended to influence a human action, and every human action has an ethical dimension insofar as it relates to the ultimate ends of human beings. Consequently, controlling employees as we have described appears to be a rather complex task that has numerous implications, as indicated in "Technical values and moral values" section. To begin with, in exercising this influence over the behavior and actions of people, the control system must respect the characteristics of human action that make it personal action. A personal action is one that originates in oneself. In Crosby's words"

"Persons act as persons by acting through themselves, that is, acting with an acting which is radically their own. My acting as a person is not an undergoing, or an enduring, or a transmitting of what originates outside of myself. It is I, I myself, who act when I act as a person and no one else" (1996, p. 26)".

This dynamic process may give rise to two different situations.

1 Not seeing herself self-actualized in technical values; the person may become increasingly dissatisfied. To compensate, she may demand that the organization increase her explicit incentive, which, from an ethical point of view, means continuing the process of de-personalization with respect to the individual's desire to perform a personal action.

2 The person may adapt by giving up the development of those technical values in exchange for the extrinsic incentive. This would mean that the control system has 'succeeded': it has de-personalized that person. But, of course, both the person and the organization are worse-off Dynamically, the situation is even more unfair, as when the organization changes the desired results, the person is unlikely to be able to adapt to the new objectives. Therefore, the person becomes 'worthless' for the organization.

When a control system does not appeal to 'moral' values, the organization and the person lose the development of the person as such, and forego the opportunity of having those values act as the starting engines of the action in the future. The question is arises why do organizations require control? Organization requires control because they consist of people with different interests, different tasks, and different perspectives. The efforts of people require a coordination and direction and this, in turn creates the need for control. The larger the number of people in an organization, the greater the need for some form of organizational control mechanism. In relatively, small entrepreneurial organizations, “control” is experienced by the entrepreneur who can see what is happening on a day to day basis and makes personal interventions.

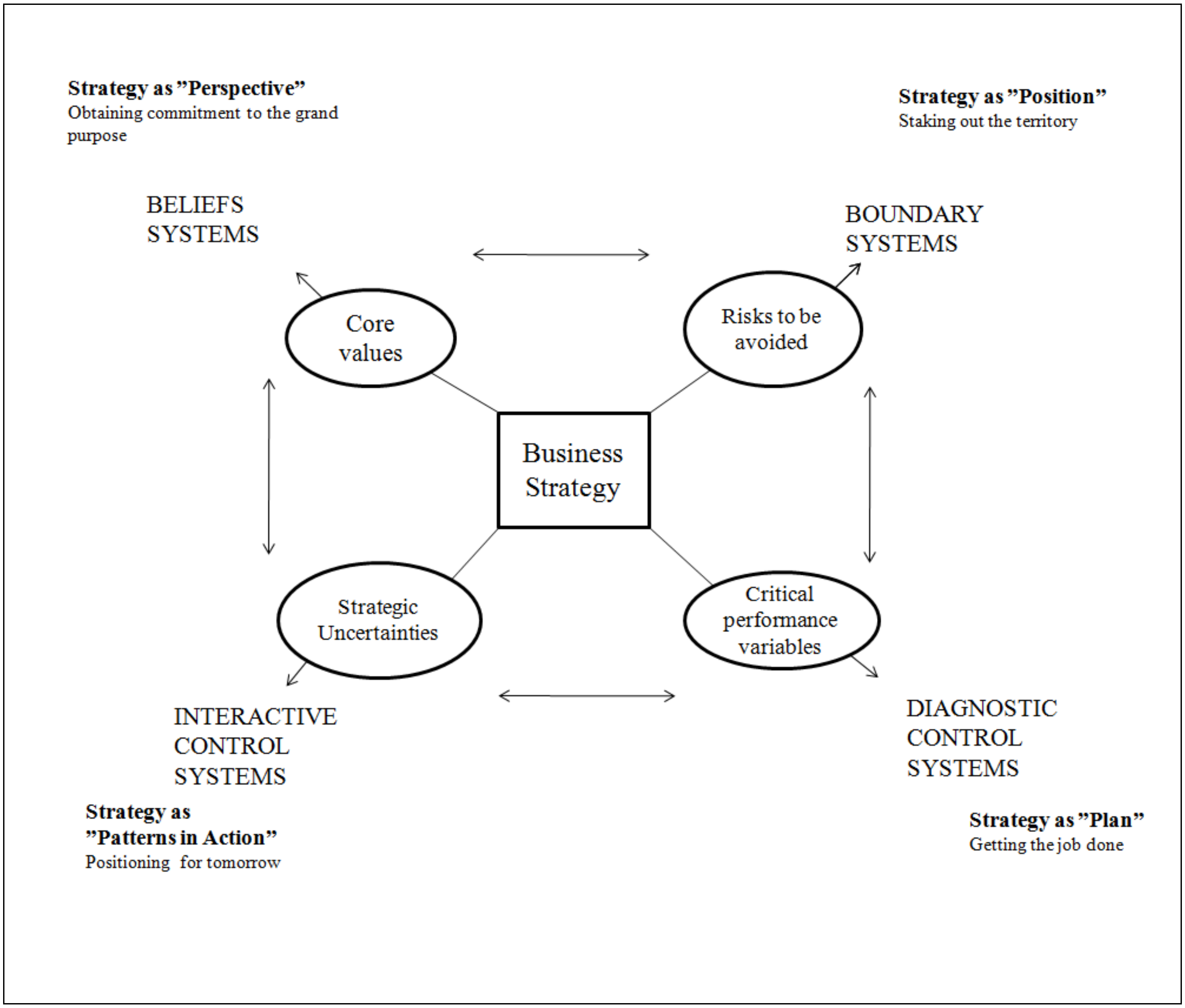
## 9. Relationship between Management Control System and Strategic Planning

Management control systems provide information that is intended to be useful to managers in performing their jobs and to assist organizations in developing and maintaining viable patterns of behaviour. Any assessment of the role of such information therefore requires consideration of how managers make use of the information being provided to them. The traditional framework for considering these issues was developed by Anthony (1965). at the Harvard Business School under the title of 'management planning and control systems'. This distinguished 'management control' from 'strategic planning' and 'operational control'.

A further weak link in the management control systems framework was also intentional. Its deliberate neglect of the process of 'strategic planning', which at best it took as given and, at worst, ignored completely, was intended to simplify the research questions asked. However, such deliberate neglect inevitably led to the specification of control systems and measures that were common to all strategies. Again, accounting measurement was stressed and non-financial performance measures were neglected. Although it may well have been sensible to concentrate initially on the core area of 'management control', it is now necessary to pay more attention to the neglected elements of strategy and operations

The relationship between management control systems (MCS) and the strategy planning is a largely unexplored area of strategic management. This paper reports the findings of an in-depth, longitudinal study of a major British-based organization operating within the increasingly globalized telecommunications industry. Informed by Simons' (1995) theoretical model of the strategy process-MCS relationship, the study examines the nature and extent of this relationship at middle- and lower-management levels. Of particular interest were the effects that the design and use of three groups of MCS have on the development of new ideas and initiatives. We beliefs systems influence managers' initiation or 'triggering' decisions, the use of administrative controls affects the location of strategic initiatives and may lead to the polarization of roles, and simultaneous emphasis on a range of key performance indicators can create a bias towards one set of measures and against another.

Figure1: shows the General relationship between Management Control System (MCS) and strategic planning-




*Source: Simons, R., "Four levers of control", Boston: Harward Business School Press, 1995, pp.159*

Understanding the effects that MCS have on managers' strategic activities is becoming imperative, not least because such knowledge will help firms develop more effective MCS to 'steer' the development of strategy and thereby secure desired strategic outcomes. This interplay between MCS, managerial endeavor and strategy is depicted in Figure 1, which establishes the conceptual framework for the present work.

## 10. Threats and Challenges comes in Management Control System

The fundamental management control problem can be expressed as follows. Any action that the controlee can take will (as a rule) influence the organization's real goal and the measured performance differently; therefore, the controlee will on occasion have to choose between an action that will bring the organization closer to its real goal but will result in a low value of measured performance, and an action that improves the performance measure but does not bring the organization any closer to its real goal. The manager's choice, of course, will depend on the incentive system:

- Suppose there is no incentive payment associated with measured performance (i.e., managers are not rewarded differently depending on the action they choose). Then, managers will choose the action on the basis of: (1) what they think is the best course of action for the organization as a whole, and (2) the utility or disutility of each action to themselves (e.g., the effort required to take certain actions, or the enjoyment in others), which will be only coincidentally related to the action's organizational usefulness. The relative importance of (1) and (2) will depend on the specific situation: of course, perfectly selfish managers will neglect the organizational goals, while managers who identify with such goals will do the opposite.
- Suppose there is a monetary incentive on the measured variable. Then, the controlee will be more inclined to do whatever improves the performance measure, but not what is best for the organization, which is only imperfectly correlated with the performance measure. If the incentive is strong enough (as it often has been in recent times, in the form of stock

options, for instance), it should not be surprising that the manager will do anything in her power (including fraud) to improve the performance measure.

These questions are likely to provide fruitful avenues for future studies but addressing them is by no means easy since the operation of management control systems as a package and organizational ambidexterity are arguably multifaceted phenomena. Therefore, larger research teams and research programs, such as the one to which this study is a subordinate, are presumably necessary when studying these issues.

## 11. Improvement and Suggestions

In management control systems, performance standards may be set by staff or managers, by managers and staff, or by managers with input from employees whose performance is being measured. The last method is the best because employees believe that line and staff do not have enough information about the conditions of various jobs to set realistic standards.

1. Managers should see that objectives and standards are measurable and that individuals are held accountable for their accomplishment. The level of difficulty should be challenging but within the capabilities of the employee. Standards set too low are usually accomplished but not exceeded, while standards set too high usually do not motivate the employee to expend much effort to reach the goal.

2. It is important that standards be complete; however, it is difficult to develop a single standard or goal that will indicate the effective overall performance. For example, consider the automobile dealer who decided to measure sales people’s performance on the basis of the number of automobiles sold. Sales increased impressively, but it was later

learned that many sales had been made to poor credit risks, and too high prices had been allowed on trade-ins.

3. Too many managers are looking for that one magic number that will tell them how well the company is doing or how their employees are performing. Standards for the automobile salespeople might have included number of sales, losses from poor credit risks, and profit on resales. Standards should also be expressed in terms that relate to the job and are meaningful to the employees.

4. Making changes as the activity is in progress is a form of corrective action. The real correction occurs when warnings rose by the forecasters or predictors are confirmed. The corrective action can be changing objectives, standards, plans, and the like, but it can also be penalizing employees when the objectives, standards, and plans are determined to be appropriate and employees have not met them.

However, there usually are several alternative corrective actions that can be taken and often more than one will prove effective. The planning control system is not effective until corrective action is taken and this action begins a new planning-control cycle.

## 12. Conclusion

The conclusion is straightforward. Although individual techniques of management accounting and control have been studied individually within a restricted context, they need also to be studied as part of a wider organizational control system. The use of management accounting and control systems can be fruitfully analyzed from the framework of performance of the employees in the context of management control system. This makes it clear that management accounting and other performance measurement practices need to be evaluated not just from an economic perspective, but from a social, behavioural and managerial perspective, within an overall organizational context. It is these social, cross-national and cultural aspects that make the study of control systems such a fascinating topic for academic research and such a challenge to the practitioner. This paper has attempted to provide an outline framework that will help both academics and practitioners to more fully understand the context in which they are working, and to help develop control practices that are well-suited to the contexts in which they are applied.

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