



An empirical investigation of the relation between the use of strategic human capital and the design of the management control system

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Abstract

This study integrates transaction cost economics and contingency theory to investigate how differences in the use of strategic human capital are associated with the design of a firm's management control system (MCS). The use of strategic human capital is hypothesized to positively influence the use of personnel and nontraditional controls while negatively influencing the use of traditional controls. Using survey data from 107 respondents, this study finds that the data do not support the hypothesized structural equation model. An alternative model is proposed that suggests only that the use of strategic human capital positively influences the use of personnel and nontraditional controls. This model is supported by the data.

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Introduction

It is widely accepted that a firm's management control system (MCS) is designed to support its strategy. Langfield-Smith (1997, p. 207) states that, "the MCS should be tailored explicitly to support the strategy of the business". Ittner and Larcker (1997, p. 295) say, "a key assumption in the strategic control literature is the need to align specific control practices with the organization's chosen strategy". Firm-level strategy variables have conceptualized strategic positioning in terms of cost leadership versus differentiation (e.g., Porter, 1980), strategic typologies in terms of prospectors versus defenders (e.g., Miles & Snow, 1978; Simons, 1987) and strategic mission in terms of build, harvest, or hold (e.g., Gupta & Govindar-

ajan, 1984). Researchers have also investigated the relation between the MCS and operational strategies such as quality (e.g., see Ittner & Larcker, 1995, 1997) and customer-focus (e.g., Abernethy & Lillis, 1995; Perera, Harrison, & Poole, 1997). But, Langfield-Smith (1997, p. 207) concludes, "our knowledge of the relationship between MCS and strategy is limited, providing considerable scope for further research".

An unexplored dimension of firm-level strategy is the firm's use of strategic resources that enable the firm to sustain its competitive advantage (Amit & Shoemaker, 1993). Specifically, this study examines the strategic resource of human capital, which includes the knowledge and skills of employees in a firm (Barney, 1991). In today's competitive environment, human capital, which enhances the knowledge of the firm, is a primary strategic resource of many firms (e.g., Quinn, Anderson, & Finkelstein, 1996). Thus, investigating

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how differences in the use of strategic human capital are associated with the design of the MCS is important, topical, and novel. In addition to being the first study to investigate how the use of a strategic resource affects the design of the MCS, this study makes three contributions to the literature.

First, this study investigates a combination of controls including personnel controls, nontraditional results controls, and traditional results controls thus responding to criticism that a more comprehensive MCS should be studied (Fisher, 1995; Milgrom & Roberts, 1995; Otley, 1980). Second, prior studies have limited themselves to investigating the affect that strategy, conceptualized broadly (e.g., prospector vs. defender), has on the design of the MCS (Langfield-Smith, 1997). This study measures four distinct attributes of a strategic resource, which include its (1) importance to the firm, (2) ambiguity (e.g., behavioral uncertainty), (3) firm-specificity, and (4) spread of use throughout the firm. Therefore, more in-depth insights are provided on the relation between strategy and the design of the MCS. Finally, investigating a combination of controls allows this study to provide insights on the trade-offs managers make between different types of controls when designing the MCS.

This study uses structural equation modeling (SEM) to test the relation between the use of strategic human capital and the design of the MCS. In addition to testing individual path coefficients, SEM provides an evaluation of the entire model thus focusing the analysis at a macro-level perspective (Kline, 1998, p. 13) and allowing insights to be drawn about the MCS as a whole, rather than simply its parts. As illustrated in Fig. 1, this study hypothesizes that the four distinct attributes of strategic human capital (importance, behavioral uncertainty, firm-specificity, and spread of use) positively influence the use of personnel and nontraditional results controls and negatively influence the use of traditional results controls. Using survey data from 107 respondents, this study finds that the data do not support the hypothesized model. An alternative model is proposed that suggests only that the use of strategic human capital positively influences the use of personnel and nontraditional results controls (e.g.,

removes the relation with traditional results controls). This model is supported by the data.

This study is organized as follows. The second section provides an overview of strategic human capital and the management control system. Section three develops the underlying theory and hypotheses. The Methods section discusses the research method and measurement of the variables. The analyses and results are presented in the Results section. Finally, conclusions, limitations, and extensions are discussed in the Conclusion.

Overview of strategic human capital and the MCS

Strategic human capital

Firms hold and control *strategic* resources in order to provide the firm with a competitive advantage (Amit & Shoemaker, 1993; Barney, 1991). Human capital, which includes the *tacit* knowledge and training of employees within the firm, is one type of resource that a firm may use strategically (Barney, 1991). Firms that use strategic human capital face challenging management control issues, especially since the individual, not the firm, owns the knowledge (Coff, 1997). As Roos and Roos (1997, p. 413) state “the crux is that it is individuals, not the company, who own and control the chief source of competitive advantage—the knowledge of organizational members”. Due to this lack of ownership, firms face high uncertainty when predicting employee behavior, tenure, and performance (Coff, 1997). To mitigate the lack of ownership of the strategic resource, firms often rely heavily on teams, networks, and other information sharing mechanisms in order to extract the *tacit* knowledge embedded in employees, thus making it more valuable to the firm (Grant, 1997; Quinn et al., 1996).

Attributes of strategic human capital

A strategic resource is one that is valued and helps the firm sustain its long-term competitive advantage through its lack of imitability. Human capital is valuable when it is important to the firm

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