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Management control systems and strategy change in buyouts

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Abstract

The impact of management buy-outs (MBO) on strategy and management control systems (MCS) is little understood. Previous research by [Ace. Org. Soc. 17 (1992) 151] focused on efficiency-enhancing buy-outs that were a feature of the early development of the market. However, MBOs are heterogeneous and more recent developments have involved ownership changes that stimulate entrepreneurial practices. The novel contribution of this paper is to use Simons' [Levers of Control: How Managers Use Innovative Control Systems to Drive Strategic Renewal, Harvard Business School, Cambridge, MA, USA] classification of beliefs systems, boundary systems, diagnostic and interactive control systems to explore management control in these newer forms of MBO. Within-case analysis and cross-case comparisons from two buyout firms are used to capture the interaction between management control systems and competitive strategy formulation, implementation and modification. This evidence supports arguments that buy-out managers undertake efforts in balancing the traditional systems with the newer systems that stimulate opportunity-seeking and learning.

Keywords: Management control systems; Strategy change; Management buyouts

1. Introduction

Management buy-outs (MBOs) represent an important threshold in the life of a company, creating a juncture at which to reconsider the strategy of a firm and its associated management control system. Jones' (1992) study of 17 MBOs completed in 1984 and 1985 shows that the budget preparation process became more appropriate, including an increase in participation. Owner-managers initiated improvements

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in the quality of information, intensified formal controls, introduced more disaggregated feedback and used existing management accounting techniques to communicate managerial philosophies. These early MBOs were strongly dominated by restructuring buy-outs that take actions to enhance efficiency and protect the firm against downside risks (Wright et al., 2000).

More recently, MBOs frequently take revitalization and entrepreneurial measures to exploit the upside potential of the firm (Wright et al., 2000). In 1994, Rehab (a pseudonym) was privatized through an MBO, taking over service contracts for disabled persons with local authorities in competition with other companies. After privatization it introduced a wheelchair renting system that lowered costs by 20% and led to 25% savings on the budgets for the municipalities. In addition to being price competitive, the firm improved service levels and developed new orthopaedic products in order to grow organically. The firm created an own dealers network, and acquired a care products firm, so that by 1997 employment had risen from 240 to with 1000 fte's. Also in 1994 Packaging (another pseudonym), which manufactures synthetic packaging for the consumer market in the food sector, was sold by its heavily constrained state owned Austrian parent in a management buy-out. After initially improving efficiency and exploiting synergies between its business units, the firm developed into a specialist in providing a wide range of specialist packaging services that demand high speed, capacity imagination and innovation. This included development of a high barrier packaging which keeps fruit fresh, allows customers to see the product and which has an easy opening facility.

Otley (1999) stresses the importance of studying management control in situations like MBOs where managers become responsible for strategy, management control and operational control. Both firms faced major opportunities and challenges that have implications for the interaction between management control systems and competitive strategy formulation, implementation and modification (Atkinson et al., 1997). The literature on management control systems has tended to focus on isolated elements in organizations such as organizational design, allocation of responsibility and accountability, planning and budgeting, reward and incentive structures, information systems and performance evaluation practices (Speklé, 2001). These cases emphasise the importance of adopting a comprehensive control system framework rather than examining isolated control mechanisms and management accounting techniques (Jones, 1992). Simons' (1995) model of the dynamic relationships between management control systems and strategic change is an attempt to offer a coherent and comprehensive body of management control theory. His framework contains four levers of control that represent important variables from literature with clear linkage to achieve strategy, e.g. beliefs systems, boundaries systems, the traditional diagnostic control systems and interactive control systems. In this paper, we use Simons' framework to explore the development of management control in these newer forms of buy-out that have significant upside entrepreneurial opportunities. We examine the questions: what changes in the content and process of the firm's strategy take place after the buy-out and why and how the directors of the firm change their management control systems to implement these strategies?

The structure is as follows: after defining an MBO, we describe the framework of levers of control. Then we link the MBO to the framework in order to highlight the role of buy-out management along four levers of control in relation with strategy. The research methodology used and data gathered are explained in the following section. Using two case studies, the role of the buy-out managers pre- and post-MBO are analyzed with regard to their potential to contribute to each of the four control levers. In a comparative analysis of the cases the differences in the way buy-out managers undertake management control activities are explained. The discussion section considers the case study evidence in the light of the existing literature and develops theoretical insights. The last section summarises the major conclusions