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An exploratory study on the emergence of management control systems: formalizing human resources in small growing firms

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Abstract

The adoption of management control systems (MCS) is a key element in managing the tension that growth imposes on young growing firms. Despite its importance to a large number of organizations, only recently has the empirical literature devoted attention to the evolution of these systems over the lifecycle of firms [Moore and Yuen, *Account. Organizat. Soc.* 26 (2001) 351]. This paper builds upon existing management control theory, mostly focused on established organizations, and existing predictions based on extended field observations to explore how these systems are adopted within growing firms. To advance theory, the paper also draws from the entrepreneurship and life cycle literatures. It identifies several variables as drivers of the emergence of management control systems including the size of the organization, its age, the replacement of the founder as CEO, and the existence of outside investors. The empirical evidence, from a database on the adoption of human resource management systems, is consistent with these variables being associated with the adoption of MCS. The paper also provides initial results on how the emergence of various types of management control systems depends on which systems the organization has already adopted.

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Introduction

Existing research taking an organizational view of management control systems (MCS) focuses mostly on the population of medium and large firms where formal systems have long been established and play a major role in structuring the organization and implementing strategy (Langfield-Smith, 1997; Luft & Shields, 2003). More-

over, the typical research design approaches the study of MCS from a cross-sectional perspective rather than taking a longitudinal view.¹ Over time, this literature has developed a rich set of variables to explain the cross-sectional variation among different types of MCS as well as among

¹ Papers that have taken a longitudinal design include Jones (1985) and Kober, Ng, and Paul (2000) who use field research to study the redesign of management control systems in processes of organizational change. Also a different line of research has examined causality in management control systems through experiment-based research designs (Fisher, Maines, Peffer, & Sprinkle, 2002; Webb, 2002).

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the characteristics of these systems (Hartmann, 2000; Shields & Shields, 1998). The theoretical underpinning, rooted in contingency (Chapman, 1997; Chenhall, 2003) and agency theories (Baiman, 1982) has emphasized a static, cross-sectional view of organizations.

However, an important transition point in the life of organizations that is receiving increasing attention is the emergence of MCS (Sandino, 2004). Lack of professional management tools such as MCS has been argued to restrain growth and even to cause the failure of firms (Greiner, 1972, 1998). MCS are important to organizational growth (Flamholtz & Randle, 2000); they liberate top managers' attention from processes that can be controlled by exception and provide them with information when their informal network is overloaded. Thus, understanding how this transition happens is an important research and managerial question. This transition point, when companies move from an informal management approach to the need for formal management tools, is most visible in the population of small growing firms.² Growing companies are faced quickly with the tensions associated with informal processes and the challenge of successfully mastering the transition into formal control systems. At this point, the dynamic process of transitioning from an informal management to the development of MCS becomes critical to the success of these organizations. So far, our understanding of how these systems emerge in growing firms is captured through experience-based models (Flamholtz & Randle, 2000; Greiner, 1972, 1998; Simons, 2000). Based on life cycle models (Kazanjian & Drazin, 1989; Miller & Friesen, 1984) of the firm, recent research (Moore & Yuen, 2001) empirically identifies the growth phase in the life cycle of an organization as the phase when MCS become important to management.

The objective of this paper is to extend current theory and examine empirically variables that are predicted to be associated with the emergence of

MCS.³ This exploratory study focuses on those systems associated with human resource management in high-technology firms. Managing human resources is likely to be one of the most challenging tasks that small growing firms face and where MCS may have an earlier role. While not exhaustive of all management control systems in an organization (therefore, the results cannot be generalized to any MCS), systems that are used to manage organizational culture, evaluate and reward employees, and code organizational processes capture a significant and important part of MCS in small growing firms. Moreover, focusing on a subset of MCS allows triangulating the data among different respondents knowledgeable of these systems, in particular CEOs and people knowledgeable about human resource practices. This triangulation has the objective of increasing the reliability of the data at the expense of reducing the scope of MCS that could have been examined, given the knowledge of the managers interviewed. Because firms typically face similar challenges in managing human resources, focusing on these systems allows cross-sectional comparability. While focusing on a subset of MCS limits extrapolation of the results beyond theoretical generalizability (Yin, 1989), previous work has taken this approach given of the benefits associated with it (Abernethy & Lillis, 1995; Gerdin, forthcoming).

Because the study relies on the experience of respondents regarding the adoption of MCS, the sample criteria include achieving a certain size over a relatively short period of time. Moreover, given the field nature of the research project a geographical criterion was also imposed. Most of the firms that meet these three criteria are in the high-technology industry, an industry that because of the dynamism associated with it has been an important research field (Burgelman, 2002), and

² The phenomenon, which is driven by small organizations outgrowing informal management processes, may also be observed within departments of medium and large firms.

³ An important line of research studies the relevance of entrepreneurial strategies (also prospector strategies) to the design of management control systems (Simons, 1987). This type of research is typically cross-sectional and focuses on entrepreneurial strategies as part of a typology of business strategies not necessarily associated with small, young firms. These studies do not examine the emergence of MCS, which is the focus of this paper.

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