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The economic benefit of goal congruence and implications for management control systems

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Abstract

In this study, we examine the importance of goal congruence in management control systems (MCS) using a theoretical framework that draws upon both agency theory and stewardship theory. Two aspects of goal congruence are considered: (1) a manager's voluntary acceptance of an organization's strategy, i.e., principal-agent alignment, and (2) manager consensus regarding their organization's strategy, i.e. agent–agent alignment among the potentially divergent interests of multiple agents. We demonstrate the impact of managers' strategy acceptance (consensus) on four measures of economic benefit: inputs (resource accumulation), outputs (volume of services), operating efficiency (output per unit of input), and cost structure flexibility (adaptability to volume). The results indicate that greater manager consensus is associated with hospitals that accumulate more resources and provide higher levels of service with greater efficiency and additional cost structure flexibility. Our evidence also indicates that hospital managers (MDs, nurses and CFOs) are not motivated by individual opportunism alone, and that goal

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congruence does not depend solely upon selecting the right performance measures and incentives to remove inefficiencies and moral hazards. We conclude that goal congruence based upon both strategy acceptance and reinforcing incentives may result in MCS that are less costly and more effective.

Keywords: Goal congruence; Strategy; Management control systems; Hospital performance; Agency theory; Stewardship theory

1. Introduction

Prior research has examined the importance of incentive contracts and performance measurement in achieving principal-agent goal congruence (Ittner and Larcker, 2001; Luft and Shields, 2003). However, goal congruence among managers does not depend solely upon selecting the *right* performance measures and incentive structures. Stewardship theory provides a complementary view of why agents pursue cooperative actions instead of opportunistic actions (Donaldson and Davis, 1991). In contrast with agency theory, stewardship theory posits that agents voluntarily exhibit cooperative or pro-organizational behavior because they place higher value (greater utility) on cooperation than self-interested behavior. Relatively little research has examined whether voluntary goal congruence described by stewardship theory affects a firm's financial performance. In this study, we consider two aspects of goal congruence: (1) a managers' voluntary acceptance of an organization's strategy (alignment of principal-agent interests) and (2) manager consensus regarding their organization's strategy (alignment of potentially divergent interests of multiple agents).[1] Strategy represents a key element of management control systems (MCS), and this study demonstrates the impact of managers' acceptance of that strategy on four measures of economic benefit: inputs (resource accumulation), outputs (volume of services), operating efficiency (output per unit of input), and cost structure flexibility (adaptability to volume).[2]

Agency theory illustrates that failure to align goals among and between a firm's principals and agents reduces organization value (lower economic performance) through increased information costs (monitoring or bonding), operating inefficiencies, or other manifestations of moral hazard. Managers rely

[1] We focus on strategy acceptance, rather than strategy categorization, which is consistent with Kaplan and Norton (2001, p. 1). For a review of existing strategy taxonomies, see Langfield-Smith (1997) and Chenhall (2003).

[2] In this paper, we define goal congruence as an individual manager's acceptance of their firm's strategy. Manager consensus is defined as the agreement among managers regarding their acceptance of their firm's strategy.