The interrelationship between management control mechanisms and strategy

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Abstract

This paper examines the interrelationship between management control system (MCS) mechanisms and strategy. The traditional view is that the MCS is shaped by organisational strategy. More contemporary viewpoints, however, suggest that there may be a two-way relationship between the two variables. That is, MCS shapes, and is shaped by, strategy.

We develop two research questions that describe the interrelationship between MCS and strategy, and test them using a public sector entity that experienced a strategic change. A retrospective longitudinal study, spanning five years and involving archival data, interviews and a questionnaire, was adopted. The analysis confirms the existence of a two-way relationship between MCS and strategy. We find that the interactive use of MCS mechanisms helps to facilitate a change in strategy, and that MCS mechanisms change to match a change in strategy.

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1. Introduction

While prior studies have highlighted the importance of achieving a fit between an organisation’s management control system (MCS)\(^3\) and its strategy (e.g., see reviews by Chenhall, 2003; Dent, 1990; Langfield-Smith, 1997), the interrelationship between MCS and strategy is not clear. Traditionally, the relationship between MCS and strategy has been viewed as a passive one, suggesting that the MCS is an outcome of organisational strategy. Hopwood (1987) and Dent (1990), however, speculated that the MCS might take a proactive role in influencing strategy. Hopwood (1987) suggested that management controls implemented for a particular reason could signal new potential, and thus unintentionally aid in the development of new directions. Macintosh (1994) recognised that the association between MCS and strategy could be more than a simple uni-directional relationship, and suggested that there may be a two-way relationship between MCS and strategy. However, while research had examined the one-way relationship, none has explored the more complex two-way association (Slagmulder, 1997).

To date, the studies that have examined the relationship between MCS and strategy in organisations undergoing change (e.g., Archer and Otley, 1991; Roberts, 1990) have concentrated on describing the controls utilised at the time of change. Consequently, these studies have described the controls used to achieve the intended strategic change but have not provided insights into the interrelationship between MCS and strategy.

Our paper synthesises, and extends, the extant literature to develop two research questions to explain the interrelationship between strategy and MCS: (1) the interactive use of MCS mechanisms helps to facilitate a change in strategy, and (2) MCS mechanisms change to match a change in strategy. Chenhall (2003) stated that understanding the role of MCS in the strategic change process is important. Our study sheds light on the strategy–MCS relationship, thus enhancing the knowledge of organisational development and organisational change process.

The research questions are tested using The Western Australian Centre for Pathology and Medical Research (known as PathCentre), which is a public sector pathology service provider that changed strategic typology in response to government reforms (i.e., the introduction of new public management (NPM) practices in the Western Australian public sector). What is interesting about this organisation is that its strategic typology evolved beyond what was originally envisaged by PathCentre management as necessary to align the organisation with the NPM reforms. While the NPM reforms created the need to change strategic direction, the reforms in themselves did not create the internal environment that enabled changes to occur. Our study examines the role of internal factors that impacted on the interrelationship between strategy and MCS at PathCentre.

A retrospective longitudinal case study of the organisation’s MCS prior to, during and after, its change in strategic typology is undertaken. Our study draws on the descriptive strengths of case study research as outlined by Ahrens and Dent (1998), and a longitudinal case study, in particular, is useful for “teasing out” the interrelationship between MCS and strategy (Dent, 1990). Furthermore, in the conduct of our study, we adopt between-methods triangulation encompassing documentation reviews, interviews, and a questionnaire. Drawing on the strengths of this mix of quantitative and qualitative methods facilitates a systematic and comprehensive analysis of the interrelationship between MCS and strategy. Specifically, while the questionnaire provides us with an understanding of strategy and the extent of use of MCS

\(^3\) MCS refers to the mix of formal and informal procedures and processes used by management to facilitate the attainment of their goals and those of the organisation (Bisbe and Otley, 2004; Otley, 1980; Otley and Berry, 1994; Ouchi, 1977).
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