



## The just design and use of management control systems as requirements for goal congruence

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### ABSTRACT

Management control systems (MCS) are designed to achieve the greatest possible goal congruence, such that people pursue personal goals that are conducive to the organizational goal. Both the use and the design of MCS are crucial for achieving goal congruence, but they are thought to be contingent to specific external situations. We analyze the basic concepts of justice and fairness, and argue that these two facets of justice, which we label “formal” and “informal” justice, need to be put in the context of MCS use and design. We argue that both formal and informal (in)justice are determinants for MCS to achieve specific levels of goal congruence, independently of the situation.

We conclude that there are two stable types of goal congruence, labeled “maximum goal congruence” – where both MCS design and MCS use are just – and “minimum goal congruence” – where both design and use are unjust; and two unstable types of goal congruence, labeled “occasional goal congruence” – where the MCS design is unjust but its use is just – and “perverse goal congruence” – where the design is just and the use is unjust. This provides a framework for future empirical research on the subject.

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### 1. Introduction

Management control systems (MCS) are intended to motivate managers to ensure that organizational objectives are accomplished. They do this by acting as controlling and enabling devices (Simons, 1990, 1994, 1995a,b), and by rewarding and promoting people according to certain criteria. Usually, they are designed to achieve the greatest possible goal congruence, i.e., a situation in which by pursuing personal goals, people also pursue organizational goals.

The literature on management control has focused mainly on formalized MCS (e.g., see Chenhall, 2003; Davila and Foster, 2007; Davila et al., 2009). In general, however, wherever a control process is implemented, formal and informal controls coexist (Anthony and Govindarajan,

2003, p. 98). In the MCS literature, the study of MCS design has evolved to capture intangibles by including more complex indicators, using what is called a balanced scorecard (Kaplan and Norton, 1992, 1993). The balanced scorecard is thought to produce a greater alignment or congruence with organizational strategy (Epstein and Manzoni, 1997; Kaplan and Norton, 1996). In a four-case study, Chapman (1998) suggests that MCS have a complementary role as devices for coping with uncertain environments.

Contingency theoretical approaches to MCS situate them in a particular situation and moment in time (Chenhall, 2003), and have been the starting point of a literature that explains how MCS can be used to reduce uncertainty while promoting innovation (Bisbe and Otley, 2004; Davila et al., 2009; Davila, 2000), as learning devices to help particular strategies (Abernethy and Brownell, 1999), and to allow for entrepreneurial activities (Davila, 2005). Recent literature in the field has expanded the concept of MCS, exploring interactive uses (Abernethy and Brownell, 1997; Bisbe and Malagueño, 2009; Bisbe and

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Otley, 2004; Simons, 1995b, 2000), and enabling uses, based on the concept of enabling bureaucracy (Ahrens and Chapman, 2004).

Recent financial scandals have sparked debates on both MCS and the concepts of justice and fairness. Governments have been forced to intervene and inject public funds into some of the companies (mainly in the financial sector) that have been at the origin of the problems. Of course, the justification for the intervention has been to avoid worse consequences for the rest of society: if banks go bankrupt, savers lose their money; and if this were to happen on a large scale, it could become a national (and international) catastrophe. What governments have done, however, is unfair, because the consequences of the misbehavior of a few have been paid for by taxpayers who (as such) did not directly create the original problem. It is also unfair that those who created the financial problems at the social level (executives in the banking industry, mainly) have not directly suffered any consequence for their misbehavior. Rather, they have derived personal material benefits from their acts in the form of salaries and bonuses, which in the end they have not had to pay back. It can be argued that there is nothing illegal (hence, 'unjust'), in this situation, but obtaining private benefits by intentionally breaking the system and provoking a socialization of losses can be legal and unfair at the same time.

Interestingly, many problems have their origin in the incentive systems of the organizations involved. Incentive systems in particular and MCS in general have the power to generate such problems when they are used unjustly and when their design is unjust. For example, many mortgage salesmen had an incentive to sell mortgages. They were paid a commission based on the total amount of mortgages sold, no matter whether the people concerned could pay the mortgages back or not. This obviously created a short-term incentive for these mortgage salesmen that went against the long-term profitability of the bank they worked for. Also, many executives had an incentive to seek the short-term profitability of their bank, which was increased by selling those mortgages and accounting for them as a good asset. After a few years (or even months), when the crisis started and it became clear that the properties had a much lower value than the mortgage loans that had been granted, the further unfair consequence was that people lost their homes because they were unable to repay the loans.

The possible dysfunctions of MCS have been well documented in the literature. They range from very specific variables (e.g., budgetary slack and short term orientation, Merchant, 1985; Van der Stede, 2000) to much wider, dynamic frameworks, such as those of Gouldner (1954), Merton (1957), and Selznick (1949), as well as subsequent work by March and Simon (1958), Hopwood (1974), and Flamholtz et al. (1985). Hopper and Powell, in a paper that goes beyond these frameworks to examine their underlying assumptions (Hopper and Powell, 1985), provide many examples of dysfunctions found in the accounting literature, from the classical papers of Argyris (1953) and Ridgeway (1956) to, say, Ashton (1976), and Burrell and Morgan (1979). Dysfunctional here means inappropriate to the objectives of the organization, or to the people

belonging to the organization. It follows that the results may be considered 'unfair' by someone else, inside or outside the organization. Thus, fairness towards someone is always an issue when dysfunctional behavior occurs (Cropanzano, 2001; Folger and Cropanzano, 1998).

For this reason, it is worth examining, on the one hand, the justice and, on the other, the use and design of MCS in order to see the role each may have played in permitting the abuses that may be the cause of the unfair consequences of MCS. In any company it is possible for a small group of managers to create and implement a MCS that pushes people in the wrong direction. By imposing ways of doing things, a MCS may benefit a small minority and create unfairness for the rest of the company.

In this paper, we study a way to address this problem and propose some solutions that have their origin inside companies, specifically regarding MCS. We attempt to show that taking justice into account in the design and use of MCS will result in greater goal alignment of individuals and, ultimately, more just consequences. Specifically, we aim to show how the (in)justice of MCS design and the (in)justice of MCS use combine to create different levels of goal alignment. Different levels of goal alignment, in turn, lead to future states that are more or less stable and that feed back into the level of justice and fairness of MCS design and use. Just uses of justly designed MCS contribute to greater goal alignment, so that, in the long run, companies achieve better results and are less likely to generate unfair external consequences. Our main contribution is based on the distinction between formal and informal justice and on the fact that both types of ex ante justice are different from the fairness of the results. Then, as we will show, the combinations of formal and informal (in)justice lead to four states of goal congruence, of which we study the dynamics. Two of these states are stable: we label them maximum and minimum goal congruence. The other two are unstable: we label them perverse and occasional goal congruence. Each of the two unstable states evolves towards one of the two stable ones. We place importance on informal justice, as the presence of informal justice makes one of the unstable states evolve towards maximum goal congruence.

MCS have been studied mainly in the organizational justice literature, especially in relation to Human Resource Management systems (Folger and Cropanzano, 1998; Gilliland and Chan, 2001). It has been found that certain characteristics of HRM systems make people perceive them as being more or less just or fair, which makes people more or less motivated to contribute to the attainment of organizational goals. As Folger and Cropanzano point out, "when individuals perceive a lack of fairness, their morale declines, they become more likely to leave their jobs, and they may even retaliate against the organization. Fair treatment, by contrast, breeds commitment intentions to remain on the job and helpful citizenship behavior that go beyond the call of formal duties. In short, justice holds people together, whereas injustice can pull them apart" (preface xii, Folger and Cropanzano, 1998).

It is important for our purposes to clarify the use of two concepts. In the organizational justice literature, 'justice' and 'fairness' have been used interchangeably and typically are linked to measures of 'organizational justice

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