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MANAGEMENT CONTROL SYSTEMS AND STRATEGY: A CRITICAL REVIEW*

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Abstract

This paper reviews research that studies the relationship between management control systems (MCS) and business strategy. Empirical research studies that use contingency approaches and case study applications are examined focusing on specific aspects of MCS and their relationship with strategy. These aspects include cost control orientation, performance evaluation and reward systems, the effect of resource sharing, the role of MCS in influencing strategic change and the choice of interactive and diagnostic controls. More contemporary approaches to the relationship between performance measurement systems and strategy are also considered. It is concluded that our knowledge of the relationship between MCS and strategy is limited, providing considerable scope for further research. A series of future research questions is presented. © 1997 Elsevier Science Ltd. All rights reserved

In recent years there has been a growing interest in the relationship between management control systems (MCS) and strategy. It has been suggested that the MCS should be tailored explicitly to support the strategy of the business to lead to competitive advantage and superior performance (Dent, 1990; Samson *et al.*, 1991; Simons, 1987a, 1990). Also, there is evidence that high organizational performance may result from a matching of an organization's environment, strategy and internal structures and systems (Govindarajan & Gupta, 1985; Govindarajan, 1988).

Strategy was not used explicitly as a variable in MCS research until the 1980s. This is surprising considering the field of business strategy or business policy has become increasingly important since it emerged in the 1950s (see Chandler, 1962). Much of the empirical research in this area follows a contingency

approach and involves a search for systematic relationships between specific elements of the MCS and the particular strategy of the organization (Simons, 1987a; Merchant, 1985b; Govindarajan & Gupta, 1985). Case studies have also been undertaken to investigate the role of the MCS in supporting and influencing the strategic processes within organizations (Simons, 1990; Roberts, 1990; Archer & Otley, 1991). The focus has been primarily on business strategy at the senior management level of the organization. However, since the mid-1980s, in the operations management literature there has been a growing interest in researching the way that manufacturing strategies can be used to gain competitive advantage (Buffa, 1984; Schonberger, 1986; Hayes *et al.*, 1988). Normative studies and single case studies have explored the relationship between MCS and

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strategy at the manufacturing level (for example, Kaplan, 1990). However, empirical research only began to emerge recently (for example, Daniel & Reitsperger, 1991).

The objective of this paper is to review and critique research that studies the relationship between MCS and strategy, and to evaluate the state of knowledge in this area. In the first section of this paper, the changing domain of MCS is considered. The second section contains a description of terminology and frameworks from the strategy literature, and an outline of strategy variables used in empirical MCS research. In the third section, contingency-style research and case studies that study the relationship between MCS and strategy are examined and critiqued. These conventional research approaches are also viewed in the light of more contemporary approaches to the design of performance measurement systems. In the final section, the limitations of the research reviewed are discussed and suggestions for further research presented.

MANAGEMENT CONTROL SYSTEMS

Management control was defined by Anthony (1965) as "the process by which managers ensure that resources are obtained and used effectively and efficiently in the accomplishment of the organization's objectives." This definition limited subsequent researchers not only to envisage MCS as encompassing the largely accounting-based controls of planning, monitoring of activities, measuring performance and integrative mechanisms, it also served to artificially separate management control from strategic control and operational control. MCS have also been described as processes for influencing behavior (Flamholtz *et al.*, 1985). MCS provide a means for gaining cooperation among collectives of individuals or organizational units who may share only par-

tially congruent objectives, and channelling those efforts toward a specified set of organizational goals (Ouchi, 1979; Flamholtz, 1983).

Controls have been categorized in many ways. For example, formal and informal controls (Anthony *et al.*, 1989), output and behavior controls (Ouchi, 1977), market, bureaucracy and clan controls (Ouchi, 1979), administrative and social controls (Hopwood, 1976), and results, action and personnel controls (Merchant, 1985a). A brief discussion of these classifications will illustrate the breadth of controls used in research.

Formal controls include rules, standard operating procedures and budgeting systems. These are the more visible, objective components of the control system, and thus, the easiest to research. Empirical research that studies MCS and strategy has focused primarily on formal controls. These include output or results controls which are of a feedback nature, and often financially oriented. They include controls that aim to ensure that specific outcomes will be achieved and involve monitoring, measuring and taking corrective actions. Controls that focus on feedforward control (*ex-anti* controls) include administrative controls (standard operating procedures and rules), personnel controls (human resource management policies) and behavior controls (the ongoing monitoring of activities and decisions).

Informal controls are not consciously designed. They include the unwritten policies of the organization and often derive from, or are an artefact of the organizational culture. Ouchi (1979) described clan controls that derive from the shared values and norms, or the culture of the organization.¹ Usually clan controls are informal, rather than formal controls. However, some formal controls also derive from the organizational culture. For example, the formal organizational mission or objectives may reflect the values and beliefs of the dominant culture. Informal controls are important aspects of MCS

¹The terms "clan control" and "social control" are often used synonymously. However, Ouchi's (1979) definition of clan control requires that there be a norm of reciprocity, the belief in a source of legitimate authority and social agreement on the range of shared beliefs and values for a "clan" to exist. Social controls can exist when there is agreement on purposes or outcomes, without there necessarily being shared belief systems.

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