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## Journal of Business Research



# Effect of transformational-leadership style and management control system on managerial performance

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## ARTICLE INFO

### Article history:

Received 20 January 2016

Received in revised form 25 July 2016

Accepted 8 August 2016

Available online xxxx

### Keywords:

Transformational-leadership style

Performance measurement system

Reward system

Broad-scope information

## ABSTRACT

Our study adds perspective on research into choices in the design of management control systems by examining: (1) how transformational-leadership style influences the choice of the design of a comprehensive performance-measurement system (PMS) and reward system; (2) how subordinate managers' reliance on broad-scope accounting (BSA) information facilitates their managerial decision-making processes and managerial performance. Our results suggest that transformational-leadership style has a significant positive and direct effect on managerial performance. We find that it has a significant positive and direct effect on the use of BSA information and comprehensive PMS, but has no significant effect on reward systems. We also find that transformational-leadership style has a partial indirect effect on managerial performance via three mediators, namely, comprehensive PMS, reward systems, and BSA information. Our findings shed light on how such mediators intervene in the relationship between transformational-leadership style and managerial performance.

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## 1. Introduction

Research acknowledges that leadership style can influence a firm's strategic priorities and implementation of formal control systems (e.g. Abernethy, Bouwens, & van Lent, 2010; Menguc, Auh, & Shih, 2007); firm innovation and creativity (e.g. García-Morales, Jiménez-Barrionuevo, & Gutiérrez-Gutiérrez, 2012; Gumusluoglu & Ilsev, 2009; Jung, 2001; Jung, Chow, & Wu, 2003; Jung, Wu, & Chow, 2008); and organizational and team performance (e.g. Braun, Peus, Weisweiler, & Frey, 2013; Birasnav, 2014; Waldman & Yammarino, 1999). Our study continues this line of research by examining the influence of leadership style on the choices in the design of management control systems (MCS), and the effect of this design on managerial performance. An MCS provides a means of gathering and processing information to assist managers in planning, control, and performance evaluation throughout the organization. The information generated by an MCS serves two main purposes: decision-influencing and decision-facilitating (Baiman, 1982; Narayanan & Davila, 1998). In an MCS's decision-influencing

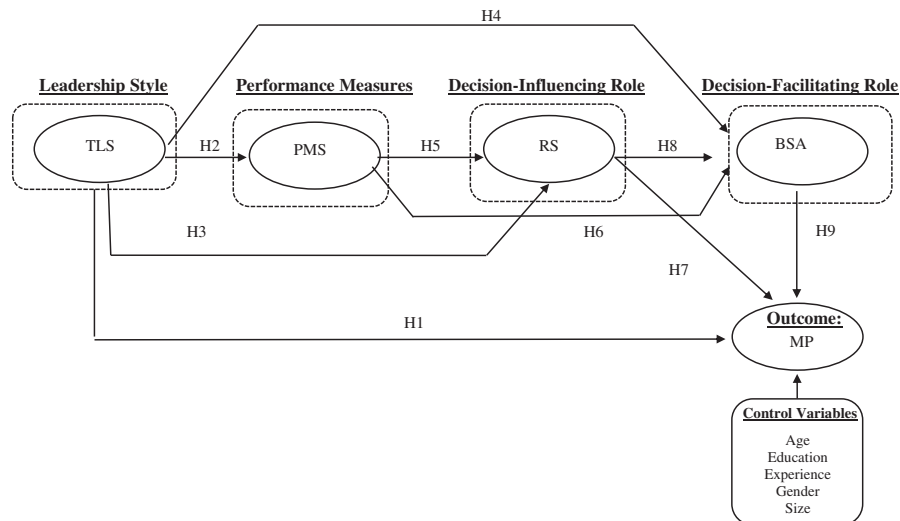
role, information is used for performance evaluation and motivational purposes. In contrast, in its decision-facilitating role, information is used for enhancing managerial decision making.<sup>1</sup>

Our study is motivated as follows. First, we find that few studies have investigated in a single study the effect of transformational-leadership style on the three MCS design choices, namely, comprehensive performance-measurement system (PMS), reward system, and reliance on broad-scope accounting (BSA) information and managerial performance. For example, Abernethy et al. (2010) examine the influence of leadership style on choice of PMS design without considering the potential effect of reward systems and BSA information on managerial performance. That is, they did not explore the influence of leadership style on the *decision-influencing role* of the reward system and the *decision-facilitating role* of the accounting-information system on managerial performance. This is despite the recognition in prior literature of the influence of leadership styles on the use of decision-facilitating information for managerial attitudes and performance. See Hopwood, 1974; Otley, 1978, and the importance of the interdependency of PMS and reward systems (see Widener, Shackell, & Demers, 2008). While Widener et al. (2008) find a complementarity between PMS and reward system, they do not consider the potential effect of the reliance on BSA

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<sup>1</sup> In the context of our study, managerial decision-making activities include planning, investigating, coordinating, evaluating, supervising, staffing, negotiating, and representing (see Mahoney et al., 1963; Mahoney, Jerdee, & Carroll, 1965).



#### Abbreviation of variables

TLS = Transformational leadership style; PMS = Comprehensive performance measurement system; RS = Reward system, BSA = BSA information; MP = Managerial performance

Fig. 1. Conceptual model.

information and managerial performance. Therefore, our study extends the research of Abernethy et al. (2010) and Widener et al. (2008) by examining the effects of transformational-leadership style on the choices of comprehensive PMS, reward systems and BSA information, as well as transformational-leadership style's effect on managerial performance. Fig. 1 depicts the conceptual model used in our study. It indicates that transformational-leadership style is positively related to managerial performance (H1), comprehensive PMS (H2), reward systems (H3), and BSA information (H4). These predictions suggest that transformational leaders motivate and inspire followers (i.e. subordinate managers) to achieve higher managerial performance and in the choices they make for MCS design. In addition, Fig. 1 reveals that comprehensive PMS is related to reward systems (H5) and BSA information (H6). This prediction suggests that a PMS can affect the decision-influencing role of the reward system and the decision-facilitating role of the BSA-information system. Finally, Fig. 1 posits that the decision-influencing role of a reward system is related to managerial performance (H7) and the use of BSA information (H8). The reliance on a BSA-information system is in turn related to managerial performance (H9).

Second, our study is motivated to address a concern proposed by Franco-Santos, Lucianetti, and Bourne (2012, p. 96; *emphasis added*) that “the impact of *comprehensive PMS* on reported performance is unclear, as the results of this body of literature are inconclusive.” We explore the role of leadership style as an *antecedent* of MCS design choice because Abernethy et al. (2010, p. 3; *emphasis added*) acknowledge that leadership style is “clearly to be an important correlated (but often omitted) variable given that *management control system* choices are the means by which top management communicate, empower and execute their vision.” We justify our choice of *transformational-leadership style* as follows. First, transformational leaders are more *charismatic and inspiring* in the eyes of their subordinates. Transformational leaders have great referent power and influence, inspire loyalty to the organization, command respect, and have the ability for important vision (House, 1977). Such attributes of transformational leaders suggest that they can develop and maintain a control system such as a reward system that recognizes and compensates managers (i.e. followers) for their efforts (Jung, 2001). Second, transformational leaders use *individualized consideration* significantly, which in turn contributes to subordinates achieving their fullest potential. Individualized consideration is a method of communicating timely information to subordinates via

coaching and mentoring. It provides for continuous follow-up and feedback. More importantly, it links an individual's current needs to the organization's mission and elevates those needs when it is appropriate to do so (Bass, 1985, 1990; Bass & Avolio, 1989). Transformational leaders pay attention to individual differences in subordinates' needs for growth and development. They set examples and assign tasks on an individual basis, not only to satisfy the immediate needs of subordinates, but also to elevate subordinates' needs and abilities to higher levels. Such characteristics of transformational leaders suggest that they can develop and maintain a control system such as a BSA-information system that recognizes the information needs of managers. The decision-facilitating role of a BSA-information system will facilitate the effectiveness of managers' managerial decisions. Third, transformational leaders use *intellectual stimulation* and challenge employees to accept innovative solutions to problems and to challenge the status quo (Bass, 1985; Berson & Avolio, 2004). Intellectual stimulation is seen in subordinates' conceptualization, comprehension, and analysis of the problems they face and the solutions they generate. Through the intellectual stimulation of subordinates, new methods of accomplishing the organization's mission are explored. Indeed, prior literature has found that transformational leadership style can develop and maintain a control system that values and rewards creativity and innovation through appropriate performance measures and reward systems (Jung, 2001; Mumford & Gustafson, 1988). Taken together, transformational leaders will rely on the decision-influencing and decision-facilitating roles of MCS information for employees' performance evaluation, motivation, and managerial decision making. We believe an investigation of the role of transformational-leadership style as an antecedent of MCS design may provide important insights into the motivations behind an organization's choice of MCS design.<sup>2</sup>

Our study contributes to the existing literature in the following ways. First, the results of our study provide insight into the *process* by which transformational-leadership style affects individuals' managerial performance through the use of comprehensive PMS, reward systems, and BSA information for managerial decision-making processes. Second, the results of our study advance the findings of prior studies (Abernethy et al., 2010; Widener et al., 2008) in relation to the following: (1) how transformational-leadership style can motivate managers' reliance on

<sup>2</sup> An MCS comprises PMS, reward system and reliance of BSA information.

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