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The importance of Management Control Systems

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ABSTRACT

This paper is trying to give us a short introduction to MCSs(Management Control systems), their definition, categories, implementation, evaluation and design in contemporary companies, as well as to underline their importance for the overall eurythmic company's function.

Key Words

Management Control Systems;Balanced Scorecard; management.

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Economics; Strategy; Management.

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1. INTRODUCTION

Management Control Systems (MCS), are a very powerful weapon in the managers' hands in order to help them ensure that their organization's goals, strategies and plans are carried out in the right way. This very critical organizational function must be implemented and supported in the right way because potential failures can lead to large financial losses, reputation damage, and even to a complete organizational failure(Merchant &V.D.Stede, 2012, pp. xii, 3).

2. MANAGEMENT CONTROL SYSTEMS (MCS)-DEFINITION AND CONTROL CATEGORIES

A very interesting definition of how management operates, is the following: "management is getting results through the work of others for the benefit of the client" (Shenhar and Renier, 1996 cited in Catasus et al., 2007, p.507). This definition is giving us the idea of how management works. MCSs, are devices or systems, which function via the use of resources(humans, financial etc.), ensures that the company's objectives are carried out , by controlling, encouraging, enabling or forcing employees, in order to perform accordingly to these objectives (Merchant and V.D.Stede,2012). Managers also have the tendency to investigate and intervening in several ways when they think that their subordinates' performance is deviating from the set targets. This is the essence of the "management-by-expectation" approach of management, as Merchant K.A. &V.D.Stede W. in "Management Control Systems" indicates (2012, p.32).

The management control systems consist of four main categories of controls, which according to Merchant &V.D.Stede (2012), are: results control, action control, personnel control, and cultural control.The **Results controls,** motivates employees in an indirect way, with a kind of reward (Merchant &V.D.Stede,2012,pp.29,40).**Actions controls**, in a direct way,taking certain steps ensuring the right actions of the employees.**Personnel controls** ensures that employees will control and motivate themselves by introducing specific behaviors which makes the employees to act in an aligned way with the interests of the organization, and **cultural controls**, encourages employees to monitor and influence each other thru a specific cultural framework that is implemented in the organization (Merchant &V.D.Stede, 2012, pp.88,81).

There are also several steps the organization takes in order to achieve a more tight result in the MCSs that are implemented. These steps are different for the different forms of the MCSs.Tight Personnel/cultural controls, exists when we have congruence between organizational and individual goals. Tight cultural control can be achieved via a strong organizational culture, which inspires and motivates employees towards the common goal, which is the achievement of the organizational targets (Merchant &V.D.Stede, 2012, p.131).Tight Results controls need specific performance targets, managers who understand well the organizational objectives, performance targets to be communicated effectively to the employees who are responsible for the implementation of the MCS, and measures to be completed in a specific area of measurements. Action control systems are tight when all employees consistently engage in all critical actions demanded, towards the company's success (Merchant &V.D.Stede, 2012, pp.123, 126).

3.IMPLEMENTATION, EVALUATION AND DESIGN OF MCSs.

It is very important here one to noticethat MCSs cannot be designed and evaluated if the objectives, and foremost, the organization's strategies, are derived from a good understanding from the employees that are having the responsibility to implement it (Merchant &V.D.Stede, 2012, pp.209).

MCS is a type of a communicating language throughout the organization, which creates a unifying way of thinking, and helps the organization to manage the potential interdependencies that arise between several parts of the organization. It also helps in several ways the organization to evolve and to make possible the planned organizational changes (Chenhall R.H. &Euske K.J., 2007).It is important to notice that the MCS in the banking sector is a combination of profitability growth and risk taking (ZoltanZeman et al.,2013).

The use of a MCS must be interactive, in order to achieve communication between managers and subordinates in different organizational levels. In this way it can be possible to debate or even to challenge the underlying assumptions and action plans that drive an organization's activities. Subordinates and managers who attained different sets of information can come together and by the combination of their knowledge to be more productive in terms of achieving organization goals (Abernethy & Lillis, 1995: Spekle, 2001 cited in Mundy J.,2010, p.501).This interactive use of MCSs represents the opportunity- seeking and learning throughout the organization(Henri J.F., 2006, p.533).The use of MCS has also a very important role in strategy implementation. (Henri J.F., 2006, p.548). With the term "strategy implementation" we mean the managerial activity by which the chosen strategy is being translated into actions (Johnson & Scholes, 1989, cited in Langfield-Smith, 1997, p.210).

Measurement, as a results control type of management, springs from the active idea that we have to measure what ought to be important to the organization (Catasus et al., 2007). Managers in order to accomplish their targets, something that will lead them to a bonus or a promotion, they tend to do their best in areas that measured and monitored, instead of those areas that are not (Ullrich and Tuttle, 2004 cited in Catasus et al., 2007, p.516). We must underline here the importance of the indicators(a number that management is interested in, due to its efforts to manage the organization), in the process of the management control system, in terms of results controlling, as a central component of the MCSs, as pointed out by Catasus et al(2007, p.517).Indicators are trying in general to be truly representative of the phenomenon they intended to characterize(Spangenberg, 2002, cited in Catasus et. al.,2007,p.508). Indicating is an act of measuring in terms of management in order to attend to important issues for the organization (Catasus et al., 2007, p.508).

It is important to underline that in most of the cases, the numbers gets measured and not the underlying activity or situation (Emiliani, 2000 cited in Catasus et al, 2007, p.507).So, this incentive method, in many cases, drive the upper managers to judge their subordinates on a number-targets basis and not due to their effort in general. Also because it exercises a lot of pressure on the managers, they tend to manipulate the performance of their subordinates in order to accomplish their very stressful targets. As we can see in Catasus et al. (2007, p.507) “all that is managed is not necessarily measured and, all that is measured is not necessarily managed”. We must underline here that interdependencies between corporate and lower level managers can affect the lower manager’s performance, thus their reward (Merchant &V.D.Stede, 2012, p.507).

The board of directors has the responsibility, among others, to implement Strategic Investment Decisions(SID). In this way they can achieve company’s long term goals, and reinforce its competitive position in the market (Marsh et al,1988; Butter et al., 1991, cited in SlamulderRegine,1997, p.103).In order to implement the overall company’s strategy they must use the right MCSand align its operation with the firms strategy (SlamulderRegine,1997, p.103).The board of directors is fully responsible and has the ultimate control over management. They are responsible for the selection and evaluation of the CEO of the company and the implementation of company’s strategy, thus for the major management decisions, such as design of equity and compensation plans (Merchant &V.D.Stede, 2012, p.561).

A“good” MCS must be implemented from managers that have the qualified leadership abilities to do so. Their own values will make them able to articulate and communicate the businesses vision to the employees in the right thus effective way. They must act like role models and make sure that their subordinates will be inspired and acquire the confidence needed in order to achieve organization’s goals (Robers, 2004 cited in Abernethy M. et al., 2010, p.3). The leadership style, the manager who is responsible for the planning and-or the implementation of the MCS has, is a crucial paragon responsible for its success. Leadership traits of higher management, which are following the intercommunicating direction from top to the bottom level, create a path which provides the MCS with the power needed to succeed (Abernethy A.M. et al., 2010, p.12).

Audit committees are very important in a MCS, because they provide an oversight on the entire company in terms of financial processes, internal controls and independent auditors. One very important aspect of audit committee’s role is to handling complaints or even impeachments of employees regarding accounting, auditing and internal control matters .They also provide independent oversight over companies, internal controls, financial processes, and helps the board in an inexpensively way to focus on financial-related reporting functions (Merchant &V.D.Stede, 2012, p.563).

MCSs face, in several occasions, severe ethical pitfalls which can be projected in social level. For example, it is very often argued that the banking sector,especially in the way it exercises its MCS nowadays, create an unjust system. That means that banks by giving incentives to its managers and them accordingly to their subordinates, i.e. to sell mortgages or credit cards or loans and to be rewarded for these sales no matter if the customers can pay back the money they have lend, creates an unstable social environment(Cuguero-Escofet N and Rosanas J.M., 2013, p.24).On the other hand the bank “golden boys” who gained a lot of money, in terms of bonuses and more, never pay for any of the consequences of their actions. Also, the banks which in a degree created the economic problem, and had (in Greece) twice been recapitalized with state’s money which means with tax-payers’ money, continue their policies with minor consequences due to the threat of their eminent bankruptcy. This behavior makes a lot of people today to argue about the ethical way banks uses their MCS through incentives given to its managers-employees (Cuguero-Escofet N and Rosanas J.M., 2013, p.24). With the term ethical, we mean a morally acceptable behavior which provide us methods of distinguishing between what is right and what is wrong and giving us guidance as to how groups and-or individuals should behave(Merchant & V.D. Stede, 2012, p.656).

Incentives are a crucial paragon in the design of a complete and effective MCS. We can also refer to them as “performance- dependent” rewards, which can provide to employees the impetus needed in order to be aligned with the organization’s objectives (Merchant & V.D.Stede, 2012, p.368). It is important to notice that there are several purposes the incentives serve, such as to inform employees for the performance area they must focus, to motivate them to perform better, to attract and retain high quality employees, and to serve non-control purposes like correlating compensation with firm performance (Merchant &V.D.Stede,2012, pp.368-369). We need to add here, that in terms of plans and budgets, they become targets that effect the managers’ motivation because the targets are linked to performance evaluations and various incentives (Merchant & V.D.Stede, 2012, p.309).

In terms of implementation controls, one can argue that if MCSs are used in an uncertain environment , then it is very likely that a combination of both formal(i.e. tight financial controls) and informal (i.e. flexible, interpersonal interactions) controls will be used(Chenhall, 2003 cited in Eldridge et al., 2014, p.68).Uncertainty has some potent effects on MCSs, such as the difficulty in implementing action controls (Merchant & V.D. Stede, 2012, p.686). So if managers want to use action controls in uncertain environments, they must use some extra tools in order to proceed, such as, more intensive pre-action reviews, get involved in more face to face meetings with the employees they want to control, and use more observation and supervision (Merchant & V.D. Stede, 2012, p.686).When we refer to uncertain environments, we refer to the difficulty one organization faces in order to predict the future because of incomplete information and-or changing conditions (Germain et al,2008, cited in Eldridge S. et al, 2014, p.67).

A way the top management implements its MCS is the Balanced Scorecard (BSC).The BSC, aims to solve the problem or strategy implementation from the higher levels of management throughout the organization (Norreklit H., 2003).Although the BSC, is a strong “weapon” the top managers has in hands in order to implement the company’s strategic objectives and to solve any problems that will occur in the way, it appears to have in many cases some shortcomings, suchas it doesn’t monitor the competition or technological developments, and that the senior managers, in most cases, do not get involved in a personal way to the whole communication with the lower levels of hierarchy about the strategies they want to implement (Norreklit H., 2003, pp.616,617).

CONCLUSION

The important of MCSs was underlined from many scholars. Their power in influencing the company's overall performance is unique. This is why companies, especially nowadays in such an antagonistic global environment, need to implement the right MCSs which with the right guidance of the "right" management will lead to better results.

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