



UNIVERSITI PUTRA MALAYSIA

***THE RELATIONSHIP BETWEEN INTERACTIVE USE OF MANAGEMENT
CONTROL SYSTEM, ORGANIZATIONAL CAPABILITIES AND
ORGANIZATIONAL PERFORMANCE***

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By

ZOHREH HAGHSHENAS



**Thesis Submitted to the Graduate School of Management, Universiti Putra Malaysia, in
Fulfillment of the Requirements for the Degree of Master of Science**

January 2013

DEDICATION

This thesis is dedicated to

ALL I LOVE



Specially

My BELOVED PARENTS

and

My DEAR HUSBAND; MOJTABA

For

THEIR ENDLESS PATIENCE AND SUPPORT

Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfilment of the requirement for the degree of Master of Science

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January 2013

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Management Control System (MCS) has attracted considerable research interests in the past decades. MCS plays an important role in providing and distributing information to support effective managerial decision-making and attainment of organizational objectives. This study focuses on the interactive use of MCS, because interactive use of MCS facilitates exploration and identification of threats and opportunities in the environment and enables them to respond quickly to changes in the environment. Resource-based view (RBV) is an often-used framework in the study of corporate competitive strategy. This study aims to examine, from a RBV perspective, the relationship between interactive use of MCS and organizational capabilities (market responsiveness, strategic networking, process reliability and efficiency, innovativeness and learning) and their subsequent impact on organizational performance.

The required data for this study were collected using a structured questionnaire, which was sent to all the companies listed in Bursa Malaysia. Seventy responses were received.

Results of this study indicate that there is a positive relationship between interactive use of MCS and organizational capabilities and overall organizational capabilities are also directly related to organizational performance. Each type of capabilities, individually, has a positive relationship with performance, but when they are analyzed together, only process reliability and efficiency make a significant contribution to explain performance.

Based on the results of the study, the overall organizational capability fully mediates the relationship between interactive use of MCS and organizational performance. It was found that not all the types of capabilities mediate the relationship between interactive use of MCS and performance; only process reliability and efficiency partially mediates this relationship.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia
sebagai memenuhi keperluan untuk ijazah Master Sains

HUBUNGAN ANTARA PENGGUNAAN INTERAKTIF SISTEM KAWALAN PENGURUSAN KEUPAYAAN ORGANISASI DAN PRESTASI ORGANISASI

Oleh

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Sistem Kawalan Pengurusan (MCS) telah menarik minat banyak penyelidikan dalam beberapa dekad lalu. MCS memainkan peranan penting dalam menyedia dan mengagihkan informasi untuk menyokong keputusan pengurusan efektif dan pencapaian objektif organisasi. Kajian ini menumpukan pada penggunaan MCS interaktif kerana penggunaannya yang interaktif membantu pengesanan dan identifikasi peluang dan ancaman di dalam persekitaran serta membolehkan pihak pengurusan untuk bertindakbalas dengan cepat terhadap perubahan-perubahan dalam persekitaran. Teori Resource Based View (RBV) memperuntukkan satu rangka kerja yang selalu digunakan dalam kajian strategi persaingan korporat. Kajian ini bertujuan untuk menyelidiki dari perspektif RBV, hubungan antara penggunaan MCS yang interaktif dan keupayaan organisasi (kebolehan pasaran membalas, rangkain strategik, proses yang kebolehpercayaan dan efisensi, inovasi dan pembelajaran) dan kesannya terhadap prestasi organisasi.

Data yang diperlukan untuk kajian ini telah dikumpul dengan menggunakan satu soal selidik berstruktur, yang dihantar kepada semua syarikat yang tersenarai di Bursa Malaysia. Tujuh puluh respon telah diterima.

Keputusan kajian ini menunjukkan bahawa hubungan positif terdapat antara penggunaan MCS yang interaktif dan keupayaan organisasi dan keupayaan organisasi secara menyeluruh adalah juga berkait secara terus dengan prestasi organisasi. Setiap jenis keupayaan, dianalisis secara individu mempunyai hubungan positif dengan prestasi, tetapi apabila mereka dianalisis bersamaan, hanya proses kebolehpercayaan dan efisensi memberi impak signifikan kepada prestasi.

Berdasarkan keputusan kajian, kemampuan organisasi keseluruhan menerangkan secara penuh hubungan antara penggunaan MCS yang interaktif dan prestasi organisasi. Adalah didapati bahawa tidak semua jenis keupayaan menerangkan hubungan antara penggunaan MCS yang interaktif dan prestasi; hanya proses kebolehpercayaan dan efisensi sahaja secara separa menerangkan hubungan tersebut.

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LIST OF ABBREVIATIONS

MCS	Management Control System
RBV	Resource-Based View
BSC	Balance Scorecard
LOC	Lever of Control
IC	Intellectual Capital
AMT	Advanced Manufacturing Technology
IT	Information Technology
BRP	Business Process Reengineering
OL	Organizational Learning
PMS	Performance Measurement System

CHAPTER 1

INTRODUCTION

1.1 Background of the Study

Business environment has undergone massive changes in terms of customers, technologies and competition. Hence, firms should adapt themselves and match their capabilities to the changing needs of customers to survive among keen competitors (Danneels, 2002). Research interests in Management Control System (MCS) have been keen for decades, but with the developments in the competitive environment, studies on MCS are taking a different perspective. Simons (1995, 2000) defines MCS as “the formal, information-based routines and procedures that managers use to maintain or change patterns in organizational activities.” MCS includes planning systems, monitoring procedures and other possible categories of control. It plays an important role in providing and distributing information in order to help managers to facilitate effective decision-making in organizations. Therefore, managers should possess the ability to identify the relevant information and use it in problem-solving. One of the biggest challenges facing management is to design effective MCS to help managers in attaining the organizational goals. MCS plays a strategic role in coping with external as well as internal uncertainties in the current highly competitive environment. Well-designed MCSs help organizations to improve efficiency and remain competitive in this ever-challenging environment. The aim of MCS is to influence company’s employees to behave in a manner that is consistent with the company’s objectives.

Much of the empirical research on MCS follows a contingency approach. Contingency-based research has attracted considerable attention in the past twenty years. Contingency theory is based on the premise that the effective design of MCS is contingent upon certain factors known as contextual variables that include business environment, technology, organizational strategy, organizational structure, organizational size and culture. According to the Govindarajan & Gupta (1985), if contextual variables are aligned properly, it leads to high organizational performance.

In order to study how managers use the management control systems as levers for strategic change, this study focuses on the interactive use of MCS as explained in Simons's (1995) levers of control (LOC). LOC framework, which highlights "a complete range of possible controls" (Otley, 2003), includes belief systems, boundary systems, diagnostic systems and interactive control systems. The LOC framework has been the focus of many management accounting research studies, such as Henri (2006), Widener (2007), Bisbe & Otley, (2004), Abernethy & Brownell, (1999) and Malagueño & Bisbe, (2010). According to the Simons (1995), interactive control system is an important control system, which facilitates innovation initiatives. Under certain circumstances, top management uses MCS more actively on a day-to-day basis in order to participate in organizational decision-making to make effective decisions. Interactive use of MCS directs manager's attention to decision problems and dialogues among managers in the organization to resolve those problems. It provides top managers the information feedback for formulation of appropriate strategies.

In the current dynamic environment, organizations need to respond quickly to the changes in the environment in order to survive and enhance their performance. The

resource-based view (RBV) theory, which is one of the more promising theories in the strategic management field, provides a theoretical perspective to explain organizational performance (Newbert, 2007). It posits that superior organizational performance is due to the organizational resources and capabilities that are rare, inimitable and non-substitutable (Barney, 1991).

The RBV theory is concerned with the relationship between firm's resources and capabilities and its performance (Barney, 1991; Rumelt, 1984). Organizational capability is a vital key to organizational success and the firm's ability to manage resources to gain competitive advantage. With increasing market globalization, companies are facing increasing risk of losing market share due to the increasing number of foreign competitors. It means that firms are no longer operating in a stable environment, but in a dynamic environment which requires companies to have a clear view of customers' needs in order to offer products that their customers need. Hence organizations should be able to adapt themselves to new changes imposed by environment to survive in changing environment (Otley, 1994). The RBV theory focuses on internal processes and resources required to meet customer's needs. There is strong evidence emphasis on customer metrics drive organizational performance (Ittner & Larcker, 1998; Kaplan & Cooper, 1998; Kaplan & Narayanan, 2001). The capabilities aim to ensure that employee efforts and skills are directed toward achieving organizational objectives.

While controlling the required outcomes or behaviors had been attracted much attention from management control literature, less attention has been paid to the resource inputs or capabilities. Therefore, management control literature needs to pay

more attention to the management of capabilities which are important organizational resources.

The shortcomings of the traditional management accounting and performance measurement system are more evident in recent years due to rising global competition (Jusoh, 2006). So companies need to develop indicators that are more consistent with their long-term goals and objectives, such as those suggested in the balanced scorecard (BSC) framework (Kaplan & Norton, 1992). In this study, organizational capabilities are categorized based on the BSC framework, which links an organization's strategy to operational objectives measured by performance indicators in both financial and non-financial terms. The performance indicators are measuring four perspectives: 1) the financial perspective, 2) the internal business perspective, 3) the customer perspective, and 4) the learning and growth perspective.

Concordant with these observations, this study contributes to the MCS literature by exploring how the interactive use of MCS by top management team acts as an antecedent to the development and management of the required organizational capabilities to facilitate achieving the organizational strategic objectives. More specifically, this study focuses on how the interactive use of MCS stimulates dialogues among managers to lead to emergence of new strategies to develop the required organizational capabilities to enhance organizational performance.

1.2 Significance of the Study

The current study is important for a number of reasons.

Firstly, from the perspective of theory development, this study incorporates the notion of RBV theory to explain the sources of competitive advantage in organizations. The current study stems from the lack of researches on examining the relationship between interactive use of MCS and organizational capabilities in Malaysia from the RBV theory perspective.

Secondly, according to the Jankala (2010), control systems in business should be used interactively in order to explore new threats and opportunities to succeed in the current dynamic environment that is characterized by rising global competition. According to the Abernethy & Brownell (1999), diagnostic control system is suitable for low level of strategic change. But in the current business environment which is highly dynamic and competitive, interactive use of MCS is appropriate to cope with the high level of strategic change. Therefore, this study focuses on how the interactive use of MCS facilitates the enhancement of the required organizational capabilities to improve competitive advantage and performance. The findings of this study may enhance understanding of the relationship between interactive use of MCS and organizational capabilities that improve organizational performance.

Lastly, there are considerable numbers of studies which have examined the relationship between contextual variables and management control system, but most of them focus on the financially-oriented budgeting systems (Dent, 1990) and few

studies are on non-financial control systems (Fisher, 1995). This study examines the organizational capabilities that are based on the BSC framework. Although only 30 percent of Malaysian manufacturing companies have implemented BSC as reported by Jusoh, Ibrahim & Zainuddin (2008), the number of companies is expected to be increased; as companies are increasing aware that the financial measures are not suitable for the current competitive environment. According to the Johnson & Kaplan (1987), financial measures might not be relevant in helping managers to make effective decisions to achieve their goals and objectives in the current rapidly changing environment. Non-financial measures are required to help organizations to monitor other non-financial objectives.

1.3 Motivation for the Study

The topic on management control system has attracted substantial attention from the academic researchers in the past two decades. In the current competitive environment, firms depend more and more on creativity and innovations to sustain their competitive advantage (Simons, 1995; Marginson, 2002). However, most of the previous studies explored the relationship between innovation and organizational performance, but few studies have examined the relationship between MCS and other organizational capabilities (Ni, Yang & Cheng, 2007). This motivates the current study to examine the relationship between the interactive use of MCS and a range of organizational capabilities, in the context of a developing country like Malaysia. Business environments in the developing countries are more dynamic and unstable due to rising

number of global competition. Therefore, businesses in developing countries have to develop necessary capabilities in order to sustain their performance.

The motivation for the current study also arises from the need to study the effects of organizational capabilities on firm's performance. According to the Epstein (2002), managers should be aware of drivers of value in organization and their ways in creating of values. According to Jusoh (2006), which was based on Malaysia, there are very few studies on the relationship between MCS and the performance measurement system. Therefore, this study intends to extend the prior research by investigating the importance of organizational capabilities as drivers of value and to determine the types of capabilities that would effectively improve organizational performance.

In addition, interactive use of MCS is selected to be the focus of this study. Since the current business environment had experienced substantial changes in customer needs and demands, it is very important for organizations to respond quickly to these changes through interactive use of their MCS because interactive use of MCS encouraged new ideas, stimulated opportunity seeking and fostered innovation. Interactive use of MCS is characterized by top managers being constantly involved in dialogues with colleagues to make appropriate decisions in attaining the organizational goals. Simons (1995) reported that high innovative companies tended to use their MCS more interactively than low innovative companies.

Another motivation is the importance of MCS among the sample of this study which are public companies listed in bursa Malaysia. As the most of them are manufacturing companies, so it is expected that they have implemented MCS in their organizations.

1.4 Problem Statement

A majority of management accounting and control literature examine either the effects of strategy on MCS or the effects of MCS on strategy (Langfield-Smith, 1977). Several authors have noted that the findings of MCS-strategy studies are ambiguous and sometimes contradictory (Chapman, 1997; Abernethy & Brownell, 1999; Ittner, Larcker, & Randall, 2003; Chenhall, 2003; Langfield-Smith, 1997). These ambiguous results may be due to the different definitions, conceptualizations and operationalizations of strategy and MCS, as well as a possible absence of a theoretical framework such as that based on the RBV in their analysis (Henri, 2006). So this study attempts to fill this gap by investigation of relationship between MCS and capabilities from a RBV perspective.

According to the Ittner & Larcker (2001), factors that lead to strategic success should be considered when studying the relationship between MCS and strategy. Few studies examined indirectly strategy in terms of innovation and organizational learning (Davila 2000; Bisbe & Otley, 2004; Henri, 2006). These conceptualizations consider strategy from a process perspective (Mintzberg & Waters, 1985). The perspective is dynamic and the focus is on issues such as the dialogues and interactions surrounding the use of MCS (Dent, 1987; Chapman, 1997, 1998). Hence, this study extends the analysis from the general strategic-choice level to the more specific capability-choice level.

Henri (2006) argues that Simons has not made a clear distinction between organizational learning and innovation. In this study, organizational learning and innovation are presented as two specific capabilities. Bisbe & Otley (2004) argue that although Simons (1995) found that an interactive control system can lead to innovation, the results do not clearly show whether an interactive control system make companies more innovative or whether it makes innovative companies more successful in terms of improved performance. So there is a need to clearly investigate effects of interactive control systems on capabilities. Although Henri (2006) found that interactive use of performance measurement system (PMS) has a positive relationship with organizational capabilities such as innovation, Bisbe & Otley (2004) found that interactive use of MCS does not always favor innovation; it can hinder innovation in specific firms that follow certain innovation strategies (Malagueno & Bisbe, 2010). In another study by Widener (2007), the results also did not support the hypothesis that interactive use of MCS facilitate enhancement of capabilities.

Kloot (1997) suggests that MCS should not only rely on traditional budgeting system, but should include non-financial measures such as those used in the BSC framework (Kaplan & Norton, 1992) to improve control because traditional control systems cannot provide a sufficient base for generative organizational learning but the new form of interactive control system could support generative learning (Driver, 2001). Financial measures ignore important issues such as customer satisfaction. So in today's dynamic environment, non-financial measures are important since they focus on quality, cycle time and customer satisfaction.

The present study attempts to extend the study conducted by Bisbe & Otley (2004) and Henri (2006) findings of this study may provide empirical evidence that could shed further lights on effect of interactive use of MCS on organizational capabilities and performance. The findings of this study may also help managers to design and use their MCS more effectively and to implement their PMS based on the BSC framework that is consistent with their organizational objectives.

1.5 Objectives of the Study

The aim of this study is to assess the relationship between MCS and organizational capabilities and to examine how organizational capabilities influence organizational performance. More specifically, this study focuses on the interactive use of MCS and a range of organizational capabilities that create competitive advantage for corporate performance enhancement.

The main and specific objectives of the study are as follows:

Overall objective

The overall objective of this study is to investigate the relationship between interactive use of MCS and organizational capabilities and their impacts on organizational performance.

Specific Objectives

The specific objectives of this study are to examine:

1. The relationship between interactive use of MCS and organizational capabilities;
2. The relationship between organizational capabilities and organizational performance;
3. The mediating role of organizational capabilities on the relationship between interactive use of MCS and organizational performance.

1.6 Research Questions

In order to ensure the objectives are attained accordingly, a number of research questions have been formulated as below:

1. To what extent does the interactive use of MCS contribute to organizational capabilities?
2. To what extent do the organizational capabilities contribute to organizational performance?
3. To what extent do organizational capabilities explain the relationship between interactive use of MCS and organizational performance?

1.7 Organization of the Thesis

The thesis has five chapters. A summary of each chapter that outlines the purpose and issues discussed in the chapter is as follows:

Chapter 1:Introduction

This chapter provides an overview of the research. It briefly explains the background of the study, followed by the significance and motivation of the study. The chapter continues with the problem statement, the research objectives and research questions.

Chapter 2:Literature Review and Theoretical Framework

Chapter two provides a review of the literature on management control system and organizational capabilities. It also incorporates the discussion on the relationship between MCS and capabilities and organizational performance. Theoretical framework of the study is presented in this chapter. This chapter also provides a discussion of variables and testable hypotheses.

Chapter 3:Research Methodology

This chapter outlines the methodology adopted in this study. Throughout this chapter, the description of the sample selection is presented. In addition, the method of collecting data is discussed. The development of the survey instrument for the study is also described in this chapter. Finally, the statistical tests used in the study and the pilot testing are described.

Chapter 4:Results and Discussions

This chapter outlines the analysis and findings of the study. The analyses include descriptive and inferential analyses. A discussion of the research findings is also presented in this chapter.

Chapter 5:Conclusions and Recommendations

The last chapter provides a summary of the study. This chapter lists some limitations for the study. Implications of the study and recommendations for future research are also discussed in this chapter.

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