4 Hypotheses and research model

This study aims at answering four distinct research questions. Firstly, this study seeks to provide evidence for the beneficial effect of indirect controls on company performance. The hypotheses for all four control forms are thus developed in Chapter 4.1. Secondly, the assumed consequences of control combinations are described in Chapter 4.2. Thirdly, the hypotheses for research questions two and four, which concern age (research question two) and other life cycle oriented moderators (research question four) are discussed in Chapter 4.3. Finally, Chapter 4.4 combines the hypotheses and presents the overall research model.

4.1 Direct effect of management control forms

This study employs a three step approach for its hypothesis development. First, it builds on theoretical considerations to determine the linkage between the chosen theoretical framework and the management control framework. Then, it presents relevant empirical research from large corporations and related disciplines. Finally, findings from the SME literature complement the hypothesis formulation.

As outlined in Chapter 3.4, this study uses agency theory to determine the effects of management control forms on organizational performance. To complement agency theory and to account for the focus on indirect forms of control, social control theory is considered as a second theoretical foundation. The fundamental assumption of this study is that the four management control forms can be attributed to the solutions provided by the agency and social control theory. The conceptual relationships used to derive hypotheses are summarized in Figure 10.

Each management control can be considered to build on different solution techniques from the theories. For example, the overall concept of personnel control consists of techniques that address issues both from the problem of adverse selection and ensure the predisposition to adapt to external norms. Executing management controls will, therefore, reduce or eliminate the presented issues. By addressing the underlying problems, management control exerts influence on employees’ behavior and aligns it with the company’s overall objectives; in turn, this is expected to improve organizational performance due to the increased resource effectiveness. The following chapters build on this assumption, explaining how management control forms are associated with the suggested solutions and linking it to previous empirical results.
4.1.1 Results control

4.1.1.1 Theoretical considerations

Results control influences organizational actors by measuring the results of their work efforts and incentivizing them in the case of target achievement. The process of how to achieve defined targets is not predetermined and is to be defined by the agent. The encouragement to ensure goal consistent behavior in this case is the incentive system. Results control addresses the agency issue of moral hazard. As the principal cannot observe all agents’ actions he uses an incentive system to partly transfer risk to the agent and provides him with freedom to pursue the goal without further interaction.

By using an incentive system and only a little interaction, the principal is able to reduce his overall control costs, while ensuring an alignment of interests. The overall control costs are expected to be moderate, as the agent, besides taking the risk of underperformance, has only negligible control or signaling costs.

SME related liabilities. As the fundamental mechanisms of interest alignment remain identical in small organizations, the characteristics of SMEs are not expected to influence the positive effects of results control.

4.1.1.2 Results control in large organizations

Previous research on results control can be attributed to both the field of accounting (budgeting, performance measurement) and incentive systems. Hence, research from both areas is considered in this study.

Accounting. OTLEY (1978), in an early study of the evaluation practices of managers, found that there is a “considerable interaction between the style (loose vs. tight to budget), budget accuracy and unit profitability.” Similarly, MERCHANT (1981) found a positive relationship between budgeting practices and corporate performance in the electronics industry. This performance effect even increased in large corporations. While investigating the effects of external uncertainty on the relationship between budgeting systems and company performance in 440 publicly held Taiwanese companies, DUH ET AL. (2006) found a positive effect of budget updating frequency, finance personnel participation and lower-level manager involvement on self-reported company performance.

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