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## **MANAGEMENT CONTROL**

*Lesson 1: Concepts, Systems, and Organisational Application*

### **1. Introduction to Management Control**

#### **1.1 Definition and Purpose**

Management control may be defined as the process by which managers at various levels in an organisation ensure that the strategies formulated at the senior level are translated into actions and that resources are used effectively and efficiently in pursuit of organisational objectives. Anthony and Govindarajan (2007, p. 6), whose work remains foundational in the field, define management control as the process by which managers influence other members of the organisation to implement the organisation's strategies. This definition highlights

two essential dimensions of control: its purposive character (oriented towards strategic goals) and its social character (involving the influence of human behaviour).

Management control occupies a distinct position within the tripartite planning and control hierarchy proposed by Anthony (1965), which distinguishes strategic planning (setting organisational goals and strategies), management control (ensuring that strategies are implemented effectively), and operational control (ensuring that specific tasks are carried out efficiently). While these three levels are analytically distinct, they are deeply interdependent in practice, and effective management control systems must be designed to integrate information flows and accountability mechanisms across all three levels.

## **1.2 The Control Process**

At its most fundamental level, the management control process follows a cybernetic model analogous to a thermostat: a desired standard of performance is established; actual performance is measured; performance is compared against the standard; and corrective action is taken where a significant deviation is detected. This feedback loop constitutes the basic architecture of any control system (Otley & Berry, 1980).

However, it is important to recognise that organisational control is considerably more complex than this mechanistic model suggests. Human behaviour is not wholly predictable or programmable; organisational goals are often ambiguous, contested, or subject to change; performance is frequently multidimensional and difficult to measure precisely; and causal relationships between managerial actions and outcomes are frequently uncertain. Effective management control systems must therefore be designed with sensitivity to these complexities, balancing formal control mechanisms with informal, social, and cultural forms

of control.

| The Four Elements of the Control Process |                                                                              |
|------------------------------------------|------------------------------------------------------------------------------|
| 1. Objective Setting:                    | Defining clear, measurable targets aligned with organisational strategy.     |
| 2. Performance Measurement:              | Collecting reliable data on actual outcomes against targets.                 |
| 3. Performance Evaluation:               | Comparing actual results with standards and diagnosing variances.            |
| 4. Corrective Action:                    | Implementing adjustments to behaviour, resources, or objectives as required. |

## 2. Management Control Systems

### 2.1 Nature and Components

A Management Control System (MCS) is the integrated set of formal and informal mechanisms—including planning processes, performance measurement systems, incentive structures, organisational structures, and cultural norms—that managers use to guide the behaviour of subordinates and support the achievement of organisational objectives. Malmi and Brown (2008) propose a comprehensive typology of MCS that encompasses planning controls, cybernetic controls (budgets, financial and non-financial measurement systems, hybrid systems), reward and compensation controls, administrative controls (governance structures, organisational design, and policies), and cultural controls (values, symbols, and clan controls).

The design of an effective MCS requires careful attention to the specific strategic, structural, and environmental context of the organisation. A

multinational corporation pursuing a differentiation strategy will require a very different control architecture from a small manufacturing firm competing on cost leadership. Contingency theory, advanced by scholars including Govindarajan and Fisher (1990), posits that there is no universally optimal MCS design; effectiveness depends upon the fit between control system characteristics and contextual variables such as strategy, environment, technology, and organisational size.

## 2.2 Formal and Informal Controls

Formal controls are explicitly designed and deliberately implemented mechanisms that govern behaviour through documented rules, procedures, targets, and incentive systems. They include financial budgets, standard operating procedures, performance appraisal systems, and internal audit processes. Informal controls, by contrast, are emergent and socially embedded; they encompass organisational culture, shared values, professional norms, and interpersonal relationships that shape behaviour without recourse to explicit rules or sanctions.

Research consistently demonstrates that informal controls are powerful complements—and sometimes substitutes—for formal mechanisms, particularly in contexts where behaviour is difficult to observe, outcomes are hard to measure, or rapid adaptation to changing circumstances is required. The management of organisational culture, therefore, is increasingly recognised as a core responsibility of senior management and an integral dimension of the management control agenda.

## 3. Key Theoretical Frameworks

### 3.1 Simons' Levers of Control

One of the most influential frameworks in contemporary management control scholarship is the Levers of Control model developed by Robert Simons (1995). Simons proposes that managers use four distinct control levers in a dynamic, complementary tension to implement strategy and manage the competing demands of innovation and control. The four levers are: Belief Systems (communicating core values and inspiring organisational commitment); Boundary Systems (establishing the limits of acceptable behaviour and preventing risk-taking beyond defined boundaries); Diagnostic Control Systems (monitoring the achievement of critical performance variables and correcting deviations from planned performance); and Interactive Control Systems (engaging managers in regular dialogue about strategic uncertainties and stimulating organisational learning).

Simons argues that sustainable value creation requires the simultaneous deployment of all four levers in appropriate balance. Over-reliance on diagnostic and boundary controls may stifle innovation and discretionary effort; insufficient attention to these controls may expose the organisation to excessive risk. The Interactive Control System is of particular strategic importance, as it enables senior managers to focus organisational attention on emerging threats and opportunities, fostering adaptive and proactive responses.

### 3.2 Agency Theory

Agency theory, rooted in the economics of information (Jensen & Meckling, 1976), provides a powerful analytical lens for understanding the design of management control systems. The theory models the relationship between a principal (e.g., shareholders or senior management) and an agent (e.g., divisional

managers or employees) as one characterised by information asymmetry and divergent interests. Because agents possess private information about their actions and capabilities that principals cannot fully observe, and because agents may be motivated by self-interest rather than the principal's objectives, control mechanisms—including monitoring systems, incentive contracts, and reporting requirements—are designed to align agent behaviour with principal interests.

While agency theory provides a rigorous economic framework for understanding control, it has been criticised for its narrow assumptions about human motivation, which reduce individuals to self-interested rational actors and neglect the role of intrinsic motivation, social norms, and professional identity in shaping behaviour. Stewardship theory offers a contrasting perspective, positing that agents may be intrinsically motivated to act in the interests of their principals, and that excessive formal control can crowd out intrinsic motivation and undermine the trust essential to effective organisational relationships.

## 4. Core Management Control Tools

### 4.1 Budgeting

The budget is the most pervasive and fundamental management control tool in practice, serving simultaneously as a planning instrument (translating strategic objectives into quantified operational plans), a coordination mechanism (aligning the activities of different organisational units), a performance standard (providing a benchmark against which actual results are evaluated), and a communication device (conveying organisational priorities and resource allocations). Merchant and Van der Stede (2017) emphasise that the effectiveness of budgetary control is heavily contingent upon the quality of the budget-setting process, the accuracy of the underlying forecasts, and the clarity

and fairness of the performance evaluation criteria applied.

Traditional annual budgeting has been subject to extensive criticism—most notably from the Beyond Budgeting movement (Hope & Fraser, 2003)—for its bureaucratic rigidity, its propensity to induce dysfunctional behaviours (such as budget gaming and sandbagging), and its inability to support the adaptive, rolling strategic management required in dynamic environments. In response, many organisations have adopted rolling forecasts, zero-based budgeting, or more flexible resource allocation mechanisms as complements or alternatives to traditional annual budgets.

#### 4.2 Responsibility Accounting and Transfer Pricing

Responsibility accounting is the system by which financial information is organised and reported in correspondence with the organisational structure of authority and accountability. Under this system, managers are held accountable for the revenues, costs, profits, or investment returns that fall within their sphere of control. Four principal types of responsibility centres are typically distinguished: cost centres (responsible for controlling costs only), revenue centres (responsible for generating revenue), profit centres (responsible for both revenues and costs), and investment centres (responsible for profits relative to invested capital, typically measured by return on investment or economic value added).

Transfer pricing—the prices at which goods, services, and intellectual property are exchanged between organisational units within the same enterprise—is a critical management control issue for decentralised organisations, influencing divisional profit measurement, resource allocation incentives, and, in

multinational corporations, tax liabilities. The design of appropriate transfer pricing mechanisms (market-based, cost-based, or negotiated) requires careful attention to the interplay of incentive effects, fairness perceptions, and strategic objectives.

#### 4.3 The Balanced Scorecard

The Balanced Scorecard (BSC), introduced by Kaplan and Norton (1992), is a strategic performance management framework that complements traditional financial performance measures with non-financial indicators across three additional perspectives: the customer perspective (how do customers see the organisation?), the internal business process perspective (at what must the organisation excel?), and the learning and growth perspective (how can the organisation continue to improve and create value?). By capturing performance across all four perspectives, the BSC provides a more balanced and comprehensive view of organisational performance than financial measures alone.

In its evolved form as a Strategy Map (Kaplan & Norton, 2004), the BSC explicitly represents the causal relationships between strategic objectives across the four perspectives, enabling managers to communicate strategy, align organisational activities with strategic priorities, and monitor progress towards strategic goals with a suite of leading and lagging indicators. The BSC has been adopted by thousands of organisations globally across public, private, and non-profit sectors and remains one of the most widely studied and applied management control innovations of the past three decades.

### 5. Contemporary Challenges in Management Control



## 5.1 Control in Decentralised and Network Organisations

The increasing prevalence of decentralised organisational structures—including divisionalised corporations, strategic business units, joint ventures, and inter-organisational networks and alliances—poses significant challenges to conventional management control models, which were largely developed in the context of hierarchically integrated enterprises. In decentralised contexts, control must be exercised primarily through output and cultural mechanisms rather than direct behavioural supervision, and the design of incentive systems that align divisional and network partner interests with overall organisational goals becomes critically important.

## 5.2 Non-Financial and Sustainability Performance Measurement

The growing recognition that financial performance metrics alone provide an insufficient basis for assessing organisational health, sustainability, and long-term value creation has driven significant innovation in non-financial performance measurement. Environmental, social, and governance (ESG) reporting frameworks—including the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), and the Task Force on Climate-related Financial Disclosures (TCFD)—are increasingly integrated into management control systems, reflecting stakeholder demands for accountability on a broader range of performance dimensions.

The integration of ESG metrics into management control and incentive systems is both technically and organisationally complex, requiring the development of robust measurement methodologies, the establishment of credible targets, and the alignment of management incentives with sustainability objectives. HR professionals, financial controllers, and operational managers must collaborate to

embed sustainability considerations meaningfully into planning, performance management, and decision-making processes.

### 5.3 Digitalisation and Real-Time Control

The digitalisation of business processes and the proliferation of real-time data analytics capabilities are transforming the practice of management control in fundamental ways. Advanced enterprise systems, business intelligence platforms, and predictive analytics tools enable managers to monitor performance continuously and in granular detail, detecting deviations from plan far more rapidly than traditional periodic reporting cycles permit. This shift from retrospective to real-time control creates new possibilities for proactive management intervention but also raises important questions about data quality, analytical capability, information overload, and the potential for surveillance to undermine managerial trust and autonomy.

## 6. Conclusion

Management control is an indispensable managerial discipline that bridges strategic intent and operational execution, ensuring that organisational resources are deployed purposefully and that performance is monitored, evaluated, and improved continuously. This lesson has examined the foundational concepts and purpose of management control, the architecture of management control systems, key theoretical frameworks—including Simons' Levers of Control and Agency Theory—and the principal tools of budgeting, responsibility accounting, and the Balanced Scorecard.

As organisations navigate increasingly complex, dynamic, and stakeholder-diverse environments, the design and operation of effective

management control systems becomes at once more challenging and more consequential. Effective management control is not merely a technical exercise in measurement and reporting, but a fundamentally human endeavour requiring sound judgement, ethical integrity, and a sophisticated understanding of the behavioural and organisational dynamics through which strategy is realised or frustrated. Students entering management practice must develop these capacities alongside a rigorous grounding in the technical dimensions of the field.

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