



The Effects of Management Control Systems on Service Quality Performance in Malaysian Local Authorities: Management Perspective

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ABSTRACT

Management control systems (MCSs) provide different valuable information which is relevant to the needs of managers at different levels in the organization. However, there is a lack of empirical evidence about how the MCSs affect the service quality performance of local authority especially in Malaysia. Through the semi-structured interviews in the preliminary survey in four local authorities in East Coast Region of Malaysia, the aim of this study is to provide evidence of the existence of MCSs practices in Malaysian local authorities and to examine the effects of the MCSs on service quality performance. The results revealed that local authorities with high concerning of internal control secure better results in service quality performance as compared to local authorities with less concerning of internal control.

Keywords: Management Control Systems, Service Quality, Local Authorities

JEL Classification: M4

1. INTRODUCTION

Over the years, the performance of Malaysian local authorities has attracted the attention of both the government and the public. The demands of the public and other stakeholders, and continuous complaints concerning the dissatisfaction with the public services, have contributed to the urgent need of accountability and transparency in delivering public services (Ibrahim and Karim, 2004; Kloot, 1999). As a result, local authorities should be concerned as to whether the services they deliver provide beneficial value to the public. To assess how far the local authorities successfully create value in their service delivery, they have to measure their performance. Therefore, one of the tools that can be used to evaluate the performance is through the implementation of management control systems (MCSs). This has been proven by previous literature, for example, Batac and Carassus (2009), Grubnic and Woods (2009), Melkers and Willoughby (2005), Midwinter (1994), Ho (2011), and Mimba et al. (2013).

In fact, Kloot (1999) and Chan (2004) noted that the local authorities should have a performance measurement system (PMS) to ensure that the public services could be delivered successfully to the community. The MCS, as part of the PMS, should be implemented systematically in an effort to increase the performance of the local authorities. Through the implementation of MCS, the service delivery to the public could be evaluated to identify whether its objectives and targets are achieved. Greiling (2006) believed that the use of a MCS in the public sector will increase the effectiveness and efficiency of the services.

In this sense, local authorities are no exception. Khalid (2010) claimed that public agencies in Malaysia, including local authorities, have implemented control systems that are used to measure the performance of the agencies in terms of the efficiency and effectiveness of the process of service delivery, human resources, financial productivity, and customers' satisfaction with the services received. Khalid (2010) found that key performance

indicators (KPIs) were implemented in Malaysian local authorities to improve the effectiveness and efficiency of the public services. In addition to that, Muhammad et al. (2015) suggested that involvement of local communities in plans or programme provided by local authorities and their point of views might help in improving the services delivery. Therefore, the objectives of this study are to look for evidence of the existence of MCS practices in Malaysian local authorities, and to examine the effects of MCS on service quality performance.

2. LITERATURE REVIEW

MCS is a system consisting of both formal and informal control (Chenhall, 2003; 2007). The formal MCS includes explicit rules, procedures, performance measures, and incentive plans that guide the behaviour of its managers and other employees. The formal control system comprises several systems, such as the management accounting system, which provides information regarding costs, revenue, and income; the human resources system, which provides information on recruiting, training, absenteeism, and accidents; and the quality system, which provides information concerning yield, defective products, and late deliveries to customers. On the other hand, Anthony and Govindarajan (2007) identified informal MCS as informal behaviour of people that include shared values, loyalties, and commitment among members of the organization, organizational culture, and the unwritten norms about acceptable behaviour of the people in the organization.

In another review paper, Macintosh and Daft (1987) classified MCS as a formal control and defined them as a package of control that includes accounting reports, budgeting, formal hierarchy and supervision, job descriptions, rules and standard operating procedures, statistics for measuring performance, organizational structure, and employees and performance appraisal systems. In other words, the formal MCS involves the formal procedures and systems to maintain or to alter patterns in organizational activities. The definitions of MCS by Macintosh and Daft (1987) appear similar to the study of Otley and Berry (1994) in which MCS are termed as being a set of procedures and processes that manager and other organizational participants use in order to ensure the achievement of their goals and the goals of the organizations.

Rosanas and Velilla (2005) highlighted MCS as a formal system that consists of goal setting, performance measurement and evaluation, and incentives. Formal control could be divided into two - financial and non-financial information. Financial information, such as budget, is basically provided for internal users for interactive controls, while other financial information is provided to the external users, such as markets, customers as well as competitors, and non-financial information is used for decision support mechanisms (Chenhall, 2003).

While some researchers only consider MCS in a formal way, some consider in both aspects, formal and informal (see, for example, Anthony and Govindarajan (2007), Chenhall (2003, 2007), Batac and Carassus (2009), Otley (1980). Furthermore, Chenhall (2003) classified informal control into personal control and social control. Personal control involves centralized decision-making in which

individuals see themselves as having more interaction on formal-related-matters (for example: Budget), and being required to explain the variances in the budget. Therefore, they are satisfied with their superior-subordinate relationships. Whereas, social control relates to how the management controls the behaviour of people in the organization in order to achieve its desired objectives, such as through the hierarchical order, institutional structure, and communication structure (Lebas and Weigenstein, 1986).

Anthony and Govindarajan (2007) also considered the process of MCS, which is much more involved with the informal interactions between one manager and another, or between a manager and their subordinates. The informal interactions normally occur through informal communications by means of memoranda, meetings, conversations, or even by facial expressions. In addition, they further acknowledge that both formal systems and informal processes influence human behaviour in organizations, and, consequently, they affect the degree to which goal congruence can be achieved. The formal control systems normally involve strategic plans, budgets, and reports, while the informal processes take into account the work ethics, management style, and culture that exists in the organization.

A more comprehensive review of the MCS component was reported by Batac and Carassus (2009). They reviewed and identified budgeting, accounting and management controls as formal control, which is accompanied by informal control. They claimed that the behaviour of the organizational members, which is considered as informal control, could influence the success of the formal control system, or, in other words, the informal control could influence the formal control. For example, if the organizational members readily follow the set of policies and procedures designed in the organization, then the MCS could be successfully implemented. In the study conducted by Cuguero-Escofet and Rosanas (2013), they treated the definition of MCS similar to Batac and Carassus (2009) who referred to formal MCS as a set of objectives and rule-based control system, while the informal MCS is needed to influence the formal control process. Further, Cuguero-Escofet and Rosanas (2013) revealed that both the formal and informal control systems are crucial in improving the performance of organizations.

Therefore, both the internal control systems whether formal or informal have been seen as a tool to enhance the monitoring and reporting processes in organization, and to ensure the compliance with laws and regulations (Jokipii, 2010). Indeed, Ittner and Larcker (1997) agreed that the internal control will lead to the higher performance. Khalid (2010) found that the internal control systems such as the use of KPIs has led the improvement in local authorities' performance. As documented by these researchers, the ultimate goal of internal control is to assure the achievement of predetermined objectives of organization. In order to perform well, internal control plays the function of monitoring, communicating, measuring, reviewing and analyzing the progress of organizational strategies in achieving the targeted goals. As empirically proven in previous studies, the positive relationship between internal control and performance has been reported (Triantafylli and Ballas, 2010; Tsamenyi et al., 2011; Yahya et al., 2008).

3. METHODOLOGY

The method used for the study was the preliminary information gathering through the semi-structured interviews, to identify the issues associated with the MCSs implementation and respondents' perceptions of the current MCSs practices in their local authorities.

A total of four face-to-face interviews of approximately 1 h for each session were conducted at one city council, two municipal councils, and one district council in East Coast Region of Malaysia. Two of the respondents are the directors, which are the Director of Treasury Department (from City Council A), and the Director of Valuation and Management Assets Department (from Municipal Council B), and the other two are Head of Quality Department (from Municipal Council C), and Head of Section of Strategic Planning Unit (from District Council D). Selection of the respondents for the interviews was restricted to departmental heads as they involve directly in strategic planning and decision making on behalf of their organization.

The ages of the interviewees ranged from 30 to 53 years while their working experience ranged from 3 to 30 years. One of the interviewees has a master degree and professional qualification (Malaysian Institute of Accountants), and the other three have a bachelor degree. With a high academic qualification of at least a bachelor degree, all the respondents are considered to be very competent to play their role in achieving the organizational objectives. Referring to Ng and Feldman (2009), education level had a positive relationship with the creativity and behaviours, and later on it will affect the job performance. Rasdi et al. (2011) also concluded the same findings which is the successful in career among managers working in the Malaysian public sector is influenced by demographic variables including the education level.

4. FINDINGS AND DISCUSSIONS

From the preliminary survey, it was found that these Malaysian local authorities are developing their own KPIs, which are guided by Malaysian Administrative Modernisation and Management Planning Unit as a tool to measure performance. At the same time, the local authorities are also controlled by the government's PMS known as the star rating system (SRS) to evaluate their performances. Through this system, the local authorities are awarded 1-5 stars to indicate their performance in which 1 star is the worst score and 5 stars is the best score. The main objectives of SRS are to monitor the performance of local authorities by increasing the efficiency and effectiveness of the service delivery, and to create competitiveness among local authorities in delivering services to the public community.

"The implementation of SRS really helps our local authority as the indicators provided by the system lead us to identify our weaknesses and strengths in achieving the organizational target," the Head of the Quality Department commented.

In fact, each head of department has the freedom to set up their departmental KPIs as long as the indicators are in line with those

of the SRS. Observations conducted at City Council A, revealed that KPIs have been developed in that council particularly to evaluate the performance of public service delivery. The achievement of the KPIs is then evaluated to measure whether or not the indicators have been achieved. The Director of Treasury Department explained:

"Through the given criteria of SRS, we know which aspects we need to focus on to improve our service delivery to citizens, which previously we never thought really important..."

However, when the SRS was first introduced by the Ministry of Housing and Local Government (MHLG) in 2008, it was supposed to help the local authority measure performance, but it was not very successful as the Municipal Council C only received 2 stars. According to the head of the quality department, this was due to the lack of awareness among the employees towards the new system, which, in turn, led to a slight drop in performance. In addition, the city council was not fully prepared for the SRS during the evaluation process. The head of the quality department commented:

"During the evaluation process, the Inspectorate Department evaluated the performance of our council based on the performance criteria of SRS, which must be supported by the relevant and formal documentation. In the first place, we didn't have proper documentation even though we had already done the performance criteria."

Without the proper documentation, the municipal council received 2 stars in the SRS evaluation in 2008. Realizing the importance of performance evaluation by the MHLG, the employees in the city council exerted more effort to increase their performance in the following years. Presenting, and keeping formal documentation and minutes encouraged the attention of top management and employees to be more responsible and accountable in conducting their tasks. Although some employees were not familiar with the new system, it did not hinder them in carrying out their responsibilities.

As the head of quality department explained: "In 2009, we had improved our performance by getting a 4-star score in SRS evaluation. This success did not come easily, but due to hard work and through cooperation among ourselves. We built the teamwork and prepared all the documentation needed, which was extremely difficult for some of us (i.e., veteran employees) who were not computer literate background."

Any local authority awarded with a high score (from 4 to 5 stars) in SRS evaluation will receive recognition from the MHLG and will be readily awarded projects or tenders for local development. In addition, the local authority will also be given funds from the MHLG to expand its local development projects. The benefits will also be reflected in how the management decide to use the funds, and, at the same time, the authority needs to at least maintain its performance for the coming years. The Head of the Quality Department commented on this issue as follows:

"The results of the SRS evaluation will be published on the website of MHLG, and local citizens will be able to see our level of performance. If our service delivery is not as expected, it will reflect badly on us."

The demand from local citizens for a better service had a significant impact on the local authority in providing more quality public service delivery, as well as creating a yardstick for successful performance. In addition, due to the deep interest shown by the local citizens, the local authority makes an effort to upgrade its management to maintain its performance and preserve its reputation.

It has been found that all the local councils that were interviewed have their own formal strategic plans and budgets for operating activities. The head of each department has the authority to monitor the processes of strategic planning and budget preparation. The head acts as a leader to their subordinates to show them how to achieve the council's goals and targets. Whenever employees of the local councils face a problem relating to their work, they can discuss with the heads to find a solution. The communication between employees and the heads is conducted in an informal way. As one of the respondents described:

“The employees are free to discuss their work problems with me directly, anytime and anywhere. No need for them to make an appointment to discuss the problems.”

The informal communications however are controlled by the formal procedures of monitoring. Any complaints from the employees will be considered and constructive feedback will be provided by the top management. In addition, the heads have formed an important body to control and monitor actions towards the operational planning of their councils, as one of the heads explained:

“We updated information regularly in management group meetings chaired by the Yang Di-Pertua on a weekly basis. We discussed what was going on in each department and looked for solutions. In the next meeting, each head of department would report the progress and actions that have been taken.”

The weekly management group meeting consisted of the heads of department, and the Yang Di-Pertua (Mayor) of the city council. The reports presented by the heads of department were evaluated and discussed thoroughly among the members of the meeting. The Yang Di-Pertua would monitor the discussion group to ensure that the agenda of the meetings could be achieved. The previous unresolved problems in each department would also be reported in the weekly meeting to monitor the actions that have been taken by the department; in the words of one of the directors:

“... Yang Di-Pertua monitors the progress of each department through the weekly meeting in order to understand the current situation and current issues relating to the city council.”

The weekly meetings show how the managerial staffs monitor the whole council even though there are no such computerized systems to control the councils. The monitoring of the performance of each department through the weekly management group meeting indicates how the top management stress the importance of monitoring in ensuring the organizational success of the councils.

In addition, each department prepares its own budget planning for operating activities. The budgets are presented in the management group meeting for amendment and approval. The Head of Treasury

Department is given the authority to approve budgets. The budgets are normally considered to be one of the action plans of the department concerning how to utilise the money for the year. One of the respondents commented:

“The annual budget is important to estimate how much money will be spent by the departments. [...] It also shows the commitment of the departments to keep their promises.”

Moreover, all the councils are now focusing on the implementation of a new system called the one stop centre (OSC) to monitor all the needs of the local community. The online system includes the processes and procedures of coordination to submit the plan advancement electronically, which is called eSubmission, and to receive comments from the technical agency electronically, which is named eProcessing. The OSC helps the councils to modernize the process of eSubmission and eProcessing and make it faster and more efficient so that the processes can be handled at any time, and, at the same time, all the records are kept properly.

In addition, any complaints lodged by the local community would be recorded in the system by providing information about the citizen who made the complaint, the type of complaint, and which department should be responsible to handle the complaint. All the information is then sent to the respective departments for action to be taken. The top management would monitor the corrective action through the OSC system, which is at their fingertips. In line with the execution of the OSC, the top management could evaluate the needs of the local community in a shorter time. According to one of the heads of department of the city council who was interviewed:

“Previously we received the complaints from the local community manually; first we needed to sort all the complaints, and then submit to the relevant departments for action. [...] Now we have the OSC. Practically it means that we have to have competent employees to handle the system. [...] As a result, we could deliver our services more effectively. OSC really helps us in monitoring corrective actions and providing better feedback to the local community.”

The top management emphasized the quality of customer service because they were becoming more aware of customer satisfaction as the solid basis for accountability and transparency. Thus, it would be beneficial for top management of the councils to understand the use of OSC in order to deliver the public services efficiently.

In addition, all the local authorities in Malaysia are bound by the external control of the MHLG, the National Council for Local Government, and also the auditing by the Auditor-General at the federal level, and the State Committee for Local Government at the state level. These lines of authority function as “watchdogs” to monitor the performance of local councils. The director interviewed described that:

“The external control guides us concerning how to deliver public services to citizens. We will be evaluated on whether or not the services provided will satisfy the citizens' needs. [...] Annual auditing by the auditor general makes us more concerned about our accountability. [...] The results of the

auditing will inevitably reveal our reputation in the eyes of the local citizens.”

The design of the MCS in the local councils was based on the external guidelines of government control and also the needs of the council itself. These controls complement the results of the performance evaluation by increasing the responsibility towards the citizens' needs and also to the goals to be achieved by shaping the organizational culture.

This preliminary information gathering provides an overview of what actually happening in the Malaysian local authorities regarding the issues of MCS and its performance. Through the observation and interviews, it was found that there were two components of internal control systems in Malaysian local authorities: Internal formal control, and internal informal control. In fact, the implementation of the MCS in Malaysian local authorities affects the role of management accountants within the organizations. It was found that their role is changing from that of accumulation, analysis and preparation of accounting related information towards the interpretation, evaluation, control, and involvement in decision making. Besides, it was also found that in some extent, the external control will affect the internal control systems, and in turn, will affect the performance of the local authorities as a whole. This findings have been proven by Ilias et al. (2016), who have verified there was a positive significant relationship between internal control systems and service quality performance in Malaysian local authorities.

5. CONCLUSION

The issues of performance of Malaysian local authorities will remain an important agenda for political leaders, managers and employees of local authorities itself, academicians, researchers and community at large. Therefore, the implementation of MCS was among the focus of the Malaysian government to increase the performance of local authorities. For those who are sceptical as to whether the implementation of MCS could improve the performance of local authorities, the findings of this study strongly suggests that MCS in general, is an important ingredient for maintaining and increasing the service quality performance. Specifically, this study contributes to the existing literature on MCS by pointing out that the internal control system is important factor to improve service quality performance.

There are, however, some limitations in this study for it only focused on local authorities in East Coast Region area. Therefore, the result might be different if the same study had been conducted in other coastal region. Second, this study had dealt with limited interviews of which only four heads of department were involved. These very limited interviews, and without taking into account the employees' perception, the result might explain the bias findings. Testing relationships of the study model variables with environmental and cultural variables, for example, is another opportunity for future research.

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