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# Management control system and governance practices in NGOs

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## Abstract

This paper forms part of a major research into the development of the management control system and governance practices in a Malaysian non-government organization (NGO). Since NGOs play an important role in the Malaysian community, they are expected to be effective and efficient in management control system and governance in order to achieve targeted goals. Using the new institutional sociology as the theoretical underpinning, this study seeks to understand why and how management control systems and governance practices emerge in the way they do within the Malaysian environment. This paper is the result of a preliminary literature review on management control systems and governance practices commonly undertaken in both for-profit as well as not-for-profit organizations in general.

**Keywords:** Management Control System, Governance, NGOs

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## 1. INTRODUCTION

Non-government organisations (NGOs) play an important role in Malaysia. They are involving in a host of humanitarian and welfare services that are valuable to the society. In view of their increasing activities that incidentally incurred substantial amount of economic resources, a proper and sound management control system as well as governance practices are thus deemed to be of paramount importance. Studies show that with proper planning of management control system NGOs to were able to perform well and carry out their duties effectively (see, e.g. Chenhall, R.H, Hall, M. & Smith, D. 2009).

The need for fund raising and its inherent demand for greater stakeholder accountability have led to the growing emphasis for evaluation of their effectiveness through performance measurement (Chenhall et al., 2010; Kaplan, 2001). The effectiveness of using their resources and at the same time the issue of accountability are often questioned. There is thus a need to examine these pertinent issues of management control and performance measurements in the ever increasing number of NGOs. However, currently only a limited number of research has been focused on this growing sector (Billis, 2010 & Osbourne, 2008). We are currently undertaking a research project to fill this lacuna in our understanding of the subject matter. Meanwhile, as a prelude to our research, we present below our literature review on the related issues.

## 2. NGO's NATURE

Based on the United Nations' definition NGOs are "private, not-for-profit organizations that aim to serve

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particular societal interests by focusing advocacy and/or operational efforts on social, political and economic goals, including equity, education, health, environmental protection and human rights” (Teegen et al., 2004, p. 466). NGOs have been described as “autonomous, non-profit making, self-governing and campaigning organizations with a focus on the well-being of others” (Gray, Bebbington & Collison, 2006).

Essentially, NGOs are not profit oriented or they do not distribute any profits to their shareholders (Hansmann, 1980). They rely on outside sources of income to support the operation activities of their organizations (Hansmann, 1980). According to Hansmann (1980), there are two types of not-for-profit organization (1) donative & (2) commercial. Donatives NGOs depend on the income from donation while commercial NGOs derived income from the sale of goods and services. There are significant differences between the activities of NGOs in various countries due to dissimilarity in legal systems, and economic environment.

NGOs are answerable to various stakeholders (e.g. donors, workers, volunteers, communities) who are heterogeneous in nature comparing to for-profit organizations which tend to serve homogeneous interest, such as serving the interest and benefit of the shareholders (Speckbacher, 2003). It seems to be more complicated serving the needs of multiple stakeholders in NGOs in respect of financial sources provided by the donors, and used by the aid providers, staff, volunteers and communities. Thus, in-depth studies on the management control system and governance for NGOs are crucial.

### **3. MANAGEMENT CONTROL SYSTEM**

Management control system is an important tool for implementing organizational strategies. Different organizations may use different strategies to enhance organizational efficiency. The excellent organization has one or more strategies. According to Haberberg and Rieple, “A strategy is the set of action through which an organization, by accident or design, develops resources and uses them to deliver services or products in a way that its users find valuable while meeting the financial and other objectives and constraints imposed by stakeholders”.

NGOs need to be proactive in making operational decisions in achieving greater operational efficiency to sustain value to the community (Jay Weerawardena, 2010). Therefore, it shows that management control system needs to be innovative and create value for the stakeholders. Recent research in management control systems (MCS) is to review the NGO 'economic capital'. The connection between MCS and social capital can potentially enhance an NGO's ability to manage the tension between attracting sufficient economic capital while sustaining cultural capital. NGOs need to remain consistent in their management practices, and maintain a high degree of integrity that is commensurate with the 'cultural capital', such as humanitarian core values, beliefs and work processes (Chenhall et al., 2010).

A further review of the literature by Chenhall et al., (2010) indicates that significant attention has been paid on the relationship of cultural capital, social capital and economic capital, and how these three types of capitals support each other in the management control system. Cultural capital is something that one acquires for equipping oneself and is reproduced by economic capital'. Whereas social capital refers to “a durable network of more or less institutionalized relationships of mutual acquaintance and recognition” (Bourdieu, 1986; Oakes et al., 1998).

The onus of having to cater for an ever increasing social obligation has compelled NGOs to work hard to find the financial funds to provide valuable services to the community (Jay Weerawardena, 2010). NGOs need to focus on the formulation of a strategy that emphasizes the management accounting controls in their organizations. There ought to be strategies to increase volunteerism and productivity while at the same time reducing its costs of operation (Handy & Srinivasan 2004). Implementing a formal control in the provision of economic capital can exert external pressure for greater accountability. Thus, it may contribute to a negative effect on internal ties and finally on delivery of services (Chenhall et al., 2010).

Performance measurement has been recognized as an important element in the management of all organizations. As defined by Ferreira and Otley (2005, 2009), performance measurement system is an effort in defining, controlling and managing to acquire the best outcomes in societal and organizational goals. It is incumbent upon top management to direct organisational efforts toward the development of an effective performance measurement system. Organisation managers need to know how, when and where to begin the changes to the performance measurement scope. In order to gain a better understanding of the performance measurement systems (PMSs), management should consider the PMSs designed by Broadbent and Laughlin (2009) and the latest frameworks developed by Ferreira and Otley (2009).

Performance management is concerned with the processes of enhancing efficiency and effectiveness at the managerial level. The processes also involve prevention and detection of errors and deviations from the policy

frameworks, with the aim of achieving conformity of services to the community. An effective performance measurement system will help to identify problem and solution. Furthermore, it will also provide monitoring of external parties and internal processes that strengthen the societal confidence and expectation at the economical cost.

In the area of performance management, accounting can be considered as one essential measurement technologies that provides widespread measure of resource provision towards accountability of those resources. Issues pertaining to the use of accounting technologies in the measurement of resource provision and managerial performance are discussed in Broadbent (2011).

Literatures relating to the studies of performance management and measurement in a for-profit organization are abound (Collier, 2005; Hyvonen, 2007; Tuomela, 2005). There are also abundant studies of performance management in public sector organizations (Kloot & Martin, 2000; Silva and Ferreira, 2010). Nevertheless, there are insufficient studies dealing with the issues of performance management in non-for-profit organizations (Chenhall et al., 2010; Roche, 2010). Other previous studies also discussed about the lack of studies on performance management in non-for-profit organizations (Henderson et al., 2002; Kaplan, 2001; Micheli & Kennerley, 2005; Sawhill & Williamson, 2001). There is a need to carry out research on the management control and performance management issues in NGOs because the study will contribute to a valuable literature (Chenhall, 2005; Ebrahim, 2003b; Hopwood, 2005; Lewis, 2003).

#### **4. GOVERNANCE IN PRACTICE**

In understanding the non-for-profit administration, we must understand that the governance of non-profit organizations is distinct in terms of mission, size, mode of operation and impact. However, several aspects of non-for-profit organizations are closely similar to a government agency or for-profit organizations (Salamon and Anheier, 1997).

In NGOs, the relationship between the funder and the recipient is tenuous. The recipient does not have absolute power in the monitoring of the organization (Ebrahim, 2003; Bebbington, 2005; Mansuri & Rao, 2012). Furthermore, the nature of governance in NGOs is often not very well understood because of incorrect expectations has been made about the role of NGOs (Helmut K. Anheier, 2000). The essential issue raised by small NGOs is that they only have very limited staff and resources. And usually this is the reason why they failed to disclose a proper reporting as requested by the funders. Occasionally, the funders need to recognize that NGOs size and positions and should consider in deciding the evaluation scale for them in performing duties.

Ebrahim (2002) raised the concern on the problems faced by NGOs, especially the small ones, in meeting the complex evaluation requirements of the funders. He further pointed out that founders' onerous data requirements could lead to the decoupling of the performance reporting systems from the actual decisions making process.

A comprehensive study of governance in not-for-profit organisations should explore the relationship between the different sections of the governance system, such as how regulation, audit, inspection and financing can affect governance structures and practices. The focus is the functions in the organizational stage or contributions by the stakeholders such as managers, employees and members and how they carry out their duties (Conforth, 2012).

Speckbacher (2008) noted that these not-for-profit organisations possess specific characteristics that are significant in shaping the organisations' adoption of control mechanisms, such as performance incentives. Because of the different contextual features of not-for-profit organisations and the context-dependent nature of organisational control (Bernardi, 1995), we can conclude that control in not-for-profit organisations is different from that in private and public sector organisations. Therefore, a substantive theory is crucial to gain an insightful understanding of similarity and distinctiveness of different organization types. The not-for-profit sector is best known for their vast difference in size, diversity and complexity of their activities. All of which invariably have an impact on their choice of internal control systems.

The role of trust is different between voluntary organisations and public or private firms, and requires considerably more investigation in the context of not-for-profit organisations (Anagnostopoulos et al., 2014). In the Malaysian context, research on NGOs is still new and there is a need to explore in greater depth. NGOs are increasing turning into essential political actors (Meyer et al., 1997, and Lewis, 1999) and not-for-profit organisations are also becoming prominent economically (Salamon et al., 1999). Currently, the majority of the not-for-profit organization are beginning to adopt business management practices and business culture especially in the United States and Europe. It has been questioned why not-for-profit organisations and their management practices are

often not well understood (Helmut K. Anheier, 2000).

## **5. PERFORMANCE MANAGEMENT & ACCOUNTABILITY ISSUES**

There have been several issues facing NGOs recently. The issues include weak controls of expenditure, lack of managerial control, difficulties of finding fund and external pressures to the managers regarding goals and mission of the organization. Another emergent issue is pertaining to spending fund raised on covering the operation costs instead of spending the fund on welfare to serve the community in need. At this point, issue of accountability towards stakeholders might exist.

'Measurement problem' encountered by NGOs as discussed by Roche (2010) contribute toward the argument over the merits, probability, and eagerness on the need for performance measurement. Three problems may arise in this situation. They are attribution, aggregation, and ownership problem. Attribution problem is regarding the relationship of cause and effect between NGOs and the particular outcome. Aggregation problem refers to the aggregation of information that may not materialize. The implementation of different programs and initiatives causes many NGOs to concentrate on the input and output measures while evaluating impact and outcomes (Roche, 2010). Lastly, NGO staffs are often under pressure to disclose up-to-date information relating to organizational performance to stakeholders. Due to this problem, sometimes the NGO staff tend to assume that the performance measurement is very dull, sometimes even intimidating and punitive (Roche, 2010).

For private sectors, their goals concentrate on the profit making and concern about performance management towards its financial controls and business. NGOs too need to develop their own performance measurement and management control systems. In order to enhance the efficiency in NGOs, the possible issues include clarifying the importance of including economic efficiency as an organizational value with traditional welfare values and linking non-financial operational performance to financial concerns. The application of performance management in management control systems has the potential of enhancing services delivery.

Accountability can be defined as "holding an individual and organization responsible for performance measured as objectively as possible" (Paul, 1991). Accountability also can be understood by answering to four main questions concerning delivery of services and performance of organization: first, "for what (purpose of services rendered), second, to whom (are the services delivered), third, when (are services delivered) and fourth, by what means (the services are delivered)?" (Manfield, 1992, p.61). Related to this, another definition of accountability is as below:

- 1) to the extent to which one must answer to higher authority legal or organizational for one's action in society at large or within one's organization.
- 2) an obligation to keep accurate records of property document or fund (Shafritz, 1992, p.4) 4

Romzek & Dubnick, (1987) research on accountability relating to a wide range of organizational expectation that developed within and outside the organization. Few researchers claimed that although research study in accountability relating to government officials is quite popular, accountability study on non-profit professional is rare. Major literature on performance measurement especially relating to monitoring, check and balance issues found significant differences in the managerial scope between governmental and for-profit organizations (Allison, 1990; Miles, 1992; pp.39-41).

## **6. RESEARCH METHOD & DESIGN**

This research study will be conducted using qualitative method using case study research. It is appropriate to use case study method since the objective of the study is to answer how and why questions as suggested by Yin, 2009. The case study approach that provides multiple data sources through triangulation with in-depth interview with informants, fieldwork observations and review of past and present documentation. Therefore, the phenomena in this study will be more reliable and accurate (Creswell, 2007). Even though, the case study method has been criticised especially in term of small sampling but according to Siggelkow (2007), proves that "a single case can be a very powerful example" (p.20). Furthermore, as asserted by Yin (2003), it is sufficient to explore a phenomenon in its real- life context through in depth case study method. The proposed research study shall be using the institutional approach as its theoretical underpinning that comprise deeply on sociological and organizational framework.

## **7. SUMMARY**

The purpose of this paper is to explore and review past studies on the importance of a management control system

and governance in the NGOs setting, as a prelude to an in-depth case study. It is observed there is only a small number of existing literature associated with the management control system in this type of organizations. The target of this study is to find out the best practices of the management control system and governance in order to achieve their goals. Since the findings might differ from public and private sector, the study on a management control system and governance for NGOs may be significant in nature.

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