



The Effects of Management Control Systems and Leadership Style on Company Performance

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Abstract

A management control system (MCS) is one of the tools used to evaluate performance at different organisational levels. This study employs the Levers of Control (LoC) dimension introduced by Simons in 1995, consisting of the belief system, boundary system, diagnostic control system, and interactive control system. Besides, leadership styles (transformational style and transactional style) are also believed to influence company performance. This study aims to investigate the role of MCS and leadership styles on company performance. The result finds that MCS and leadership styles have a significant positive impact on company performance. The findings also suggest that the transactional leadership style and the diagnostic control system could improve company performance.

Keywords: Management Control System (MCS), Leadership Style (LoC), Company Performance.

JEL: L14, L25, M12

SDG: SDG8, Target 8.2

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1. Introduction

Company performance becomes the most important thing for companies to evaluate. However, good company performance can only be achieved if the company can maximally manage and allocate resources (Ningrum et al., 2017). One of the tools used to support ideal company performance by managing the existing resources is the management control system or MCS (Porporato, 2006). A management control system is a designed condition to increase profitability by determining, assessing, and reducing the gap between expected and actual goals. It has an enormous role for companies, especially manufacturing companies (Merchant & Otley, 2006).

In 1995, the Levers of Control (LoC) was first introduced as a tool to measure management control systems (Simons, 1995). It consists of four different systems' dimensions to generate effective control, namely, belief systems, boundary systems, diagnostic control systems, and interactive control systems. Failures in implementing an ideal MCS will impact the company's reputation, financial losses, and sustainability.

Besides a sound management control system, the leaders' capabilities are also necessary to improve company performance. However, the concept of leadership still leaves a debate as it involves management thought. Defining leadership is not an easy task because of the complexity of the subject (Koech & Namusonge, 2012).

Leadership can be defined according to the purpose associated and can present a wide range of possibilities (Avolio et al., 1989). It can be seen as a combination of personalities, art, actions, the relationship power, the result of an interaction, and the role. In conclusion, leadership is a set of characteristics owned by managers to influence employees. Leadership style affects company performance as it can increase motivation and commitment from employees to work well and follow expectations (Khan & Adnan, 2014).

In Indonesia, several companies experienced a decline in performance because companies failed to maintain their sustainability related to systems of control and leadership. Nyonya Meneer herbal medicine factory was declared bankrupt in 2017. The company failed to compete with its competitors in marketing its (herb) products, making the company unable to generate maximum profit (Tempo, 2017). PT Sariwangi Agriculture Estate Agency, an Indonesian tea company, was declared bankrupt in 2018 because it failed to cover its debts and generate the expected target (Kompas.com, 2018).

Gaps in academic research discussing the maximisation of control systems and leadership styles on company performance need to be fulfilled. Therefore, this study aims to examine the influence of management control systems and leadership styles on company performance.

2. Literature review

2.1 Management control systems and company performance

Management control systems (MCS) are a package of tools used by a leader to control organisational members, making it easier to make decisions and take actions in the company's best interests (Malmi & Brown, 2008). The MCS has four dimensions: belief system, boundary system, diagnostic control system, and interactive control system called Levers of Control (Simons, 1995). Its framework combines positive controls (belief system and interactive

control system) and negative controls (boundary system and diagnostic control system) (Adi & Sukmawati, 2020). Thus, discussing MCS in the Indonesian context is more appropriate by employing the LOC framework as Asian society believes in *yin-yang*: a balance between two opposites.

Levers of Control (LoC) was introduced by Simons in 1995 to classify the functions of management control systems. The beliefs system is a control-oriented system that seeks the company's core values so that managers can explore the company's capabilities to increase company performance. Boundary systems are controls that focus on identifying mistakes that can hinder operations and worsen company performance. Diagnostic control systems are management controls carried out by managers to diagnose and identify factors that can result in better performance. Interactive control systems are controls that focus on analysing challenges and opportunities to discover new ideas and creativity. To increase company performance successfully, the company must simultaneously implement all of the LoC dimensions (Ferreira & Otley, 2009).

The emergence of a balanced management control system has been continuously discussed as it has a big role in company performance. Companies need to assess the internal and external environment to understand opportunities and challenges to sustain in the markets (Henri, 2006). MCS is believed to improve company performance as it can increase mutual commitment and coordinated action that leads to the expected results (Adler & Chen, 2011). It can also increase efficiency in finding solutions to problems related to evaluation and performance (Duréndez et al., 2016; McGrath, 2001).

Several papers have frequently discussed this topic and showed mixed results in implementing MCS. Research conducted on 900 Spanish SMEs (Durendez et al., 2016) found that MCS implementation positively impacts company performance for both family businesses and non-family businesses. Therefore, the hypothesis for this study is as follows:

H₁: Management control system affects company performance

2.2 Leadership style and company performance

Companies adopt best practices and procedures of effective leadership to maintain their sustainability. Effective leadership could lead to management development and the accomplishment of sustainable competitive advantage. This leader can help a company achieve its goals more efficiently by linking performance with rewards and ensuring that employees can carry out their responsibilities (Ojokuku et al., 2012). A leader has control of both tangible and intangible resources and the effective combination, depending on their type of leadership (Khan & Adnan, 2014).

Leadership style is a bilateral process of social influences, and it affects both managers and employees to achieve company goals (Ngodo, 2008). It can help the organisation build a good relationship between leaders and employees. Leadership style is seen as a combination of managers' personalities, characteristics, skills, and behaviours when interacting with their employees (Mitonga-Monga & Cilliers, 2018). In the last two decades, researchers discussed transactional and transformational leadership styles. The transformational style occurs when employees are promoted to raise awareness regarding productivity matters and transcendence for expected goals. Hence, managers who apply a transformational leadership style focus on developing employee values, motivation levels and morality with skills development (Ismail et al., 2009). Leaders with a transformational style will provide vision and motivation to

employees to achieve goals and objectives to generate high productivity and profitability. Transformational style leaders achieve remarkable performance since they can inspire their employees to explore capabilities and develop creative problem-solving skills.

The transactional leadership style is compliance-based, promoting reward and punishment (Burns, 1978). It mainly focuses on physical and security needs. This style attaches rewards to achieving goals and associates performance with return values (Zhu et al., 2005). This implies that managers only focus on employee's performance accomplishments to a company's goals (Boehnke et al., 2003). Leaders with this style will reward employees only when they can achieve targets (Humphreys, 2002).

There are various leadership styles, such as charismatic, transitional, transactional, transformational, visionary, and cultural-based leadership styles. However, in the last two decades, more researchers discussed transactional and transformational leadership styles. Some research findings show that transformational and transactional leadership styles affect company performance (Khan & Adnan, 2014; Tran, 2017). Additionally, some stated that transformational leadership styles have more impact than other leadership styles on company performance (Khan & Adnan, 2014) as they promote long-term vision and inspiration, which campaigns escalated contributions of employees beyond the call of duty (Nguyen et al., 2017).

As leaders have an essential role in every organisational performance, researchers agreed that a leader's existence could make the performance of an organisation more dynamic. Researchers have frequently discussed the impact of leadership style on company performance. Research conducted on 20 selected Nigerian banks (Ojokuku et al., 2012) and 137 Malaysian financial firms (Lo et al., 2013) found that leadership style has a strong relationship with company performance. Specifically, the transformational leadership style is preferably implemented in the banking sector (Ojokuku et al., 2012), hotels (Tran, 2017), and the Kaosiung's Nanzi Export Processing Zone in South Taiwan (Wang et al., 2010). Following the review, the relevant hypothesis is as follows:

H₂: Leadership style affects company performance

3. Research methodology

3.1. Population and samples

The population in this research is managers of Indonesian manufacturing companies. We focused on manufacturing companies as the operational activities in this industry are complex. Therefore, the decision on the management control system and leadership style being implemented are essential to performance.

Samples were picked up using a non-probability sampling method because it is the most convenient sample taking. The sampling method was also chosen to collect more respondents in a more cost-saving manner. We approached managers of Indonesian manufacturing companies through e-mail and social media. The e-mail address and social media profile are obtained from Google Search and profile search on social media, such as LinkedIn, Twitter, Facebook, and Instagram. We then shared the link to the questionnaire and let the respondents fill in the responses. So, in this case, the respondents completed the questionnaires anonymously.

3.2. Variable operationalisation

Company performance is employed as a dependent variable, while the management control system and leadership styles are the independent variables. The company performance is measured by a self-evaluation questionnaire adopted by Widener (2007) using several indicators, such as the overall organisation performance, the overall organisation profitability, the market share for primary products, and the distribution of primary products. The MCS is also measured by a self-evaluation questionnaire developed by Widener (2007) through the four dimensions. The dimensions are (1) belief systems, whether values and the company's direction can be well communicated; (2) boundary systems, whether the efficiency of the system is created as a border for employees; (3) diagnostic control system, to see the efficiency of organisational controls; and (4) interactive control system, to see the manager involvement in decision making. Lastly, the leadership style is measured by a questionnaire adopted by Avolio et al. (1991). The transactional leadership style is proxied by three indicators: contingent reward, active management exception, and passive management exception. Meanwhile, the transformational leadership style is proxied by four indicators, such as intellectual stimulation, idealised influence, inspirational motivation, and individualised consideration. All of those variables, along with their indicators, are measured using a 7-point Likert scale.

Table 2 Variable codification and measurement

Variable	Code	Measurement
Belief systems	mcs_bel	7-point Likert scale
Boundary systems	mcs_bou	7-point Likert scale
Interactive control system	mcs_int	7-point Likert scale
Diagnostics control systems	mcs_dia	7-point Likert scale
Management Control System	MCS	Average of <i>mcs_bel</i> , <i>mcs_bou</i> , <i>mcs_int</i> , and <i>mcs_dia</i> .
Transformational leadership	lead_tform	7-point Likert scale
Transactional leadership	lead_tsact	7-point Likert scale
Leadership Style	LEAD	Average of <i>lead_tform</i> and <i>lead_tsact</i> .
Company Performance (Y)	perform	7-point Likert scale

3.3 Data collection technique and analysis tool

We collected the data from questionnaires distributed online. The questionnaire set (see Appendix 1) was sent to manufacturing company managers or leaders whose contact information can be traced through the Internet. After obtaining and tabulating it, we analysed the data through multiple linear regression. The primary proposed model (Model I) in this study is as follows:

Model I:

$$perform = \alpha + \beta_1MCS + \beta_2LEAD$$

We also split MCS and LEAD into their components or dimensions to understand deeper the impacts of MCS dimensions and leadership styles on company performance. Therefore, in addition to model 1, we have other models (model II, model III, and model IV) tested in this study. In model II, MCS and LEAD are extracted from their components. We would like to see the impact of those dimensions on corporate performance.

Model II:

$$perform = \alpha + \beta1mcs_bel + \beta2mcs_bou + \beta3mcs_int + \beta4mcs_dia + \beta5lead_tform + \beta6lead_tsact$$

Model III:

$$perform = \alpha + \beta1mcs_bel + \beta2mcs_bou + \beta3mcs_int + \beta4mcs_dia + \beta5lead_tform$$

Model IV:

$$perform = \alpha + \beta1mcs_bel + \beta2mcs_bou + \beta3mcs_int + \beta4mcs_dia + \beta5lead_tsact$$

For model III and model IV, we kept the dimensions of MCS in both models and different leadership styles in each model. In these two models, we wanted to see which leadership style can be best-combined with MCS dimensions to improve corporate performance.

4. Results and discussion

4.1 Descriptive statistics

We successfully collected 41 sets of answers from respondents. More than 85% of the respondents are male, and the rest are female managers. The respondents come from various age groups, which mostly come from the 30-39 age group. In terms of length of service, almost 44% of the respondents are very loyal to their organisation, being in service for more than ten years. Table 1 below shows the complete characteristics of respondents in this study.

Table 2 Respondent characteristics

Respondent Characteristics	Amount	Frequency
Gender		
Male	35	85.36%
Female	6	14.63%
<i>Total</i>	<i>41</i>	<i>100%</i>
Age		
20-29 years old	5	12.19%
30-39 years old	19	46.34%
40-49 years old	13	31.71%
>50 Years old	4	9.76%
<i>Total</i>	<i>41</i>	<i>100%</i>
Length of Service		
<1 year	1	2.44%
1-5 years	12	29.27%
6-10 years	10	24.39%
11-15 years	8	19.51%
>15 years	10	24.39%
<i>Total</i>	<i>41</i>	<i>100%</i>

The questionnaire consists of 24 questions for the management control system, 15 questions for leadership styles, and four questions for company performance. Each of these questions is measured using a 7-point Likert scale. Table 2 shows that the average points of all variables are above 5.0.

Table 2 Descriptive Statistics

Variable	Mean	Min	Max
Management Control System (X1)	5.79	3.74	7.00
<i>Belief (mcs_bel)</i>	5.86	4.00	7.00
<i>Boundary (mcs_bou)</i>	6.08	3.25	7.00
<i>Interactive (mcs_int)</i>	5.20	3.67	7.00
<i>Diagnostics (mcs_dia)</i>	6.00	3.08	7.00
Leadership Style (X2)	6.05	4.26	7.00
<i>Transformational (lead_tform)</i>	6.20	4.38	7.00
<i>Transactional (lead_tsact)</i>	5.90	4.14	7.00
Company Performance (Y)	5.73	4.00	7.00

Management Control System has four dimensions, namely belief control (*mcs_belief*), boundary control (*mcs_bou*), interactive control (*mcs_int*), and diagnostics control (*mcs_dia*). Overall, the mean score of the variable MCS is 5.79. Out of these controls, *mcs_bou* is, on average, the highest, implying that most companies implement boundary control systems. The second highest is *mcs_dia*, followed by *mcs_bel*. The interactive control has the lowest mean score and the only control system dimension below the average.

Variable leadership style has an average score of 6.05, with 4.26 of the minimum score and 7.00 of the maximum score. Out of the two leadership styles, the transformational style (*lead_tform*) is mostly implemented by companies. The variable performance has a mean score of 5.73, with 4.00 of the minimum score and 7.00 of the maximum score.

4.2 hypothetical testing result

Table 3 Multiple linear regression results

Variable	Model I	Model II	Model III	Model IV
MCS	0.39**			
LEAD	0.46**			
<i>mcs_bel</i>		0.05	0.03	0.17
<i>mcs_bou</i>		-0.13	-0.14	-0.08
<i>mcs_dia</i>		0.49*	0.52*	0.41
<i>mcs_int</i>		-0.05	-0.04	-0.05
<i>lead_tform</i>		0.40	0.47**	
<i>lead_tsact</i>		0.07		0.31*
_cons	0.72	0.63	0.64	1.18
N	41	41	41	41
r ²	0.46	0.53	0.53	0.49

* p<0.05; ** p<0.01; *** p<0.001

Table 3 shows the result of the regression test to confirm hypotheses. In Model I, the result shows that both *MCS* and *LEAD* can positively influence company performance. However, when the two variables are separated into their sub-variables (Model II), diagnostic control is the only determinant of performance. We learn that leadership styles and control systems are determinants of company performance. But, if a manager enforces both leadership styles at the same time, none of them could be helpful for performance improvement. In this case, only the diagnostic control system can improve company performance, which is in line with research findings by Jamil and Mohamed (2013).

In model III and model IV, we kept all the sub-variables of leadership styles and one different leadership style in each model. As shown in Model III, the transformational leadership style and diagnostics management control system together can significantly influence company performance. Diagnostic MCS is believed to be effective as it can increase performance when uncertainty is low, but it does not reduce performance in a highly uncertain situation (Sakka, Barki, and Côté, 2013). However, the transactional leadership style is the only determinant of performance among the tested variables in Model IV. No other independent variable significantly influences company performance in the model.

4.2.1 management control systems on company performance

The multiple regression analysis shows that the management control system has a significant positive effect on Indonesia's manufacturing companies' performance. This result confirms a better MCS implementation in a company can increase company performance. The ideal implementation of MCS encourages organised action in achieving the expected results through direct communication between managers and employees. These engagements can reduce uncertainty and lead to better performance. Furthermore, MCS can also increase efficiency in finding related solutions by evaluating the movements that have been taken. If companies extensively implement the control system to monitor progress, the performance is likely to improve as stakeholders can take immediate action whenever a situation is getting hard. Thus, a sound management control system could influence company performance (Ningrum et al., 2017; Nurainun, 2018; Ratmono & Nahartyo, 2012).

4.2.2 leadership style on company performance

The multiple regression analysis also shows that the leadership style has a significant positive effect on company performance for Indonesia's manufacturing companies. This result confirms a better leadership style applied in a company can generate better company performance. The finding is consistent with some research stating that a supportive leadership style has a positive impact on company performance (Khan & Adnan, 2014; Koech & Namusonge, 2012).

The leadership style of managers is considered one of the main strength factors in a company. It forces every employee to understand and to give suggestions when needed. This understanding can lead the employees to understand their role, and the leader can understand the needs of employees (Wang et al., 2010). The condition where the leaders and employees understand each other can reduce misunderstanding, which can hinder and delay both of them in achieving the company's goals. Besides efficiently utilising human resources (employees), ideal managers also provide motivation and encouragement for employees, so they can work better to achieve the company's goals with less supervision (Ojokuku et al., 2012).

5. Conclusion

The management control system and leadership style have a significant positive effect on the performance of Indonesian manufacturing companies. This finding indicates that an ideal control system in management and inspiring leadership styles could boost company performance.

There is a limitation in conducting this research. We researched Indonesian manufacturing companies, and the findings are very empirical. We consider that each industry is unique and has a different influence level of MCS and leadership styles on corporate performance. Future

researchers could explore this topic in other industries that are seldom touched upon in academia such as service businesses.

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Appendix 1: Questionnaires

QUESTIONNAIRE

Respondent Identity

Name :
 Company Name :
 Position :

Gender	Age	Level of Education	Length of work (years)
Male	20 - 29	High School	1 – 5
Female	30 -39	Diploma	6 - 10
	40 - 49	Bachelor	11 – 15
	>= 50	Master	>15
		Doctor	

A. Company Performance

No.	Questionnaire Item	1 = very bad					7 = very good	
		1	2	3	4	5	6	7
a)	Overall company performance							
b)	Overall company profitability							
c)	Market share for primary products							
d)	The overall productivity of the primary product distribution							

B. Management Control System (MCS)

No.	Questionnaire Item	1	2	3	4	5	6	7
B.1. Beliefs System								
		1 = not clearly described			7 = very clearly described			
a)	Your company mission statement can describe the company’s core values to employees							
b)	You communicate the company’s core values to employees							
c)	The employees understand the company’s core value							
d)	The company mission statement can motivate employees							
B.2. Boundary System								
		1 = strongly disagree			7 = strongly agree			
a)	Your company relies on business ethics to determine appropriate behaviour for employees							
b)	Your business ethic provides employees with restricted behaviour information about							
c)	Your company has a system that lets employees understand what risks to avoid							
d)	Your employees understand the company’s business ethic							
B.3. Diagnostic Control System								
		1 = never			7 = very often			
a)	Evaluating goals achieving progress							
b)	Monitoring work result							
c)	Comparing results with expectations							
d)	Analysing the main steps in achieving company goals							
e)	Actively discuss with managers and employees in a meeting							
f)	Conduct regular meetings regarding basic data, assumptions, and planning							
g)	Provide the company’s overview							
h)	Maintaining the company together							
i)	Allows companies to focus on common problems							
j)	Allows companies to focus on critical success factors							
B.4. Interactive Control System								
		1 = strongly disagree			7 = strongly agree			
a)	Top management pays little attention to performance appraisals							
b)	Top management relies on managers in preparing and interpreting information from the performance measurement system							
c)	Operations managers are rarely involved, except in matters relating to performance appraisals							
d)	Top managers always pay attention to the performance appraisal system							
e)	Top managers interpret the information from the performance appraisal system							
f)	Managers are often involved in performance appraisal systems							

C. Leadership Style

No.	Questionnaire Item	1 = strongly disagree				7 = strongly agree		
		1	2	3	4	5	6	7
C.1. Transformational Style								
a)	You instil a sense of pride in employees							
b)	You have time to teach and train employees							
c)	You always consider morals and ethics when interacting with employees							
d)	You see that employees have different needs, abilities, and aspirations							
e)	You always listen to employee concerns							
f)	You can increase employee motivation to work							
g)	You can encourage employees to think more creatively							
h)	You can make employees think creatively but never question the ideas							
C.2. Transactional Style								
a)	You clearly set goals							
b)	You set challenging standards							
c)	You inform clearly the standards in performing work							
d)	You always encourage employees to do something							
e)	You quickly take action before the problem becomes chronic							
f)	You make agreements with the employee							
g)	You manage the performance and evaluate mistakes made by employees							