

Management Control Systems Practices in Small and Medium Enterprises

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RESEARCH ARTICLE

Abstract

Small and medium-sized enterprises (SMEs) comprise 99.6% of the Philippine economy. Many studies have said that SMEs do not need and do not use management control systems (MCS) due to their simple organizational structure and limited resources. Most MCS research and their empirical evidence have nearly been completely founded on information from bigger organizations or their sub-units. It has been expressed that modern Management Accounting Practices (MAPs) and sophisticated systems may likewise be valuable for private ventures, albeit small firms may have dissimilar needs than their larger counterpart. Thus, this study determines the MCS adopted and used in SMEs in Misamis Occidental. A descriptive study using a survey questionnaire was administered to 100 randomly selected SMEs in Misamis Occidental. The questionnaires were personally delivered and administered to facilitate questions raised by the respondents regarding the items in the survey. The result showed that SMEs in Misamis Occidental utilize a wide scope of MCS practices and information. However, numerous practices are not incorporated as profoundly and systematically into their business operations. The outcome also shows that MCS is themed with financial, customer-oriented, and strategic-oriented controls. Thus, aside from designing MCS suited to SMEs, there is a need to guide them in the technical application, adoption, and utilization of MCS data. The data can be used as a base for additional scholarly examination in business.

Keywords: Management Control Systems, Small and Medium Enterprises, Financial Controls, Strategic-Oriented Controls, Customer-Oriented Controls

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1 INTRODUCTION

Micro, small, and medium enterprises (MSMEs) play significant functions in the Philippine economy. They represent 99.6 percent of the 777,687 total business enterprises in the Philippines, while large companies represent the remaining 0.4 percent as of 2010, based on the National Statistics Office. According to the Senate Economic Planning Office in 2012, the MSMEs add to the development of the Philippines by creating jobs for the workforce, fueling economic advancement in the rural areas, and serving as associates to large entities as providers and suppliers of support services.

Entrepreneurs are tasked to run the business smoothly to meet the growing challenges and demands of the corporate environment. Pihlela, Odunaiké, and Durban (2012) said that timely information on an organization's operations is needed in order for it to succeed. To be able to get these, the operations have to be monitored and measured constantly.

Management control means “any actions, activities, procedures or norms activated in an organization to influence the probability that organizational participants’ behavior will lead to the attainment of negotiated levels of objectives” (Herath, 2007).

Management control systems (MCS), as defined by Anthony and Govindarajan (2007), are “the process by which managers ensure that resources are obtained and used effectively and efficiently in the accomplishment of the organization’s objectives.” MCS means the “use of several techniques in an organization to observe and evaluate employee performance against certain management targets. Conventional MCS focuses on getting better operational efficiency” (Armesh, Salarzahi, & Kord, 2010).

MCS is a “recurring and formalized set of institutionalized protocols, routines or information gathering mechanisms designed to assist managers in making decisions or fulfilling their responsibilities” (Davila & Foster, 2006). MCS infers a cognizant plan of each control component and the collaboration job of each part of the organization, a plan to impact the conduct of individuals in the association (Silva-Domingo, 2015).

MCS empowers managers to avoid losing control due to the absence of checking and cope with increased information needs (Chenhall, 2003). In any case, MCS is expensive and tedious to install and operate. This would require the entrepreneur to formalize the business’s activities. Past research put forward that small private ventures take part in less formalized, more operational, and closer to personal planning than bigger firms and that they use friends, family, and magazines to gather data (Pearce, Freeman, & Robinson, 1987). (Baird & Orris, 1994) pointed out that formal planners have an average of 101 employees, which, under the Philippine definition, is already considered a medium enterprise. Hence, it tends to be seen that as an enterprise grows, it is more inclined to formalize operations.

Micro-enterprises comprise 91.6%, 8 percent are small enterprises, and 0.4 percent are medium enterprises of the total SMEs. According to the Magna Carta for Small Enterprises (1997):

“An MSME is “any business activity or enterprise engaged in industry, agri-business, and services that have: (1) an asset size (less land) of up to Php100 million; and (2) an employment size with less than 200 employees regardless of the type of business ownership.” (p. 1)

The number of workers employed in the business is usually the basis used to determine the size of an enterprise (Jamil & Mohamed, 2011).

Most MCS research and their empirical evidence have nearly been completely founded on information from bigger organizations or their sub-units (Chenhall, 2003). Singh, Garg, and Deshmukh (2008) expressed that modern MAPs and sophisticated systems may likewise be valuable for private ventures, albeit small firms may have dissimilar needs than their larger counterpart. It can be inferred that for the past years, research on the role of MCS in SMEs has been limited, opening opportunities for researchers in this area (Reid & Smith, 2000).

For Chenhall (2003) the objective of MCS research is to give discoveries that help managers accomplish their objectives or those of their association. He likewise recommended contingency-based examinations to initially set up the selection and utilization of MCS, then to look at how they are used to redesign decision quality. Lastly, research joins with business execution. He mentioned that some MCS researchers have unequivocally considered size a logical variable. In the primary, studies have analyzed large associations, ordinarily advocating this as large firms will generally embrace the practices fused inside more conventional MCS.

Studies that have analyzed size as a variable have considered its belongings and different setting components. Notwithstanding, the issues hidden in the selections of MCS in SMEs contrast from those stood up to by large firms: (1) large firms typically have a broad measure of formal frameworks already in place; (2) SMEs use informal controls more strongly than do large firms (Cugueró-Escofet & Rosanas, 2011; Davila & Foster, 2006). This examination adds to the writing on observational investigations about MCS in SMEs.

Cugueró-Escofet and Rosanas (2011) stated that it is a typical perception that most little

associations have simple conventional control frameworks. As referred to in Cugueró-Escofet and Rosanas (2011), Tannenbaum, Beard, McNall, and Salas (2010) said that associations without control are unimaginable; they should have informal control frameworks. Informal control frameworks may assume a significant part at any phase of an association's turn of events. Davila and Foster (2006) said that most associations have some form of informal control before embracing formal control frameworks. This leads to the research question: What management controls do SMEs adopt and use in their operations?

2 METHODS

The research utilized the descriptive method. A modified questionnaire was adopted for the study. The study was done among the SMEs of Misamis Occidental. The respondents came from companies with more than ten years in the industry, which would provide credence to the agency being more formally managed. This basis follows the similar rules of past research that consider the organizations that are not over ten years of age as young (Duréndez, Madrid-Guijarro, & Garcia-Perez-de Lema, 2011). For the survey of the study, 100 SMEs were randomly selected from the list provided by the provincial office of the Department of Trade and Industry.

The questionnaire in the study is an adaptation from the work of Jänkälä (2007) on "MCS in the Small Business Context." The questionnaire was pretested among 15 SMEs to get its reliability. This number of respondents was not included in the final sample size. The overall reliability of the measure use of MCS information supporting the business management was 0.962 as measured by the Cronbach Alpha. The Cronbach Alpha of the different categories are all greater than 0.8; this implies that the scales possess high reliability and internal consistency.

Frequency distribution was used to determine the adoption rate of the different MCS practices among the surveyed SMEs. The goal set for this work was to determine whether SMEs use MCS practices and data. The essential thinking applied in the operationalization of the questions in this investigation was the point at which a firm uses the proposed MCS information, from once in a while (very sometimes, on occasion, frequently, scored 13) to efficiently insert as a piece of their typical activities (scored 4), by then it is interpreted that the firm has utilized the practice required for delivering the data. On the other hand, if a firm reports that it does not utilize the item (scored 0) on the survey, it is interpreted that the practice has not been embraced or executed in a firm. Because of the more restricted assets that SMEs have contrasted with bigger firms, it is sensible to acknowledge that the use of MCS practice in SMEs leads in like manner at any rate to the intermittent utilization of that practice, for example, to its adoption. Following Chenhall and Langfield-Smith (1998) study, the adoption rates were grouped. However, the groupings do not infer any absolute level of adoption. The groupings are as follows:

High Adoption = > 90%

Moderate Adoption = > 80% < 90%

Low Adoption = < 80%

Descriptive statistics for the questions were computed dependent on the scores on the scale from not utilized (scored 0) to utilized efficiently as a part of ordinary activities (scored 4). With regards to adoption ranks, the items were grouped into three: high use ($x > 2.50$), moderate use ($x \Rightarrow 2.0$), and low use ($x < 2.0$). This grouping is still drawn from Chenhall and Langfield-Smith (1998). Be that as it may, about adoption, this grouping is just an estimation and does not speak of any absolute utilization figures.

3 RESULTS AND DISCUSSION

This study aimed to document the management control systems that SMEs adopt and their practices. In Table 1, the rankings are coordinated into three: relative high adoption (23 practices), relative moderate adoption (17 practices), and relatively low adoption (16 practices). The table additionally shows that more than most studied SMEs embrace the MCS practices and information proposed in the study. Thus, the surveyed SMEs do use them, even if only occasionally.

At any rate, 90% of the organizations utilized 23 distinct reports and analyses with a relatively high adoption. Of these 23 distinct reports and analyses, nine are from traditional financial management practices, four from new sophisticated MCS practices, and three from conventional MCS practices, market and customer-oriented practices, and strategic-oriented practices. Such a high accentuating of financial performance measures and the price of profitability of products and services is in line with Laitinen as referred to by Garengo, Biazzo, and Bititci (2005) and Reid and Smith (2000).

Table 1. Relative adoption of MCS practices and information

n=46	Rank
Relative High Adoption	
1. Pricing based on a full-costing approach	1 98%
2. Quality improvement analysis	2 96%
3. Personnel analysis (performance, satisfaction, etc.)	2 96%
4. Analysis of business strengths and weaknesses, etc.	2 96%
5. Budgets (annual, flexible, or rolling)	3 93%
6. Product and service profitability analysis	3 93%
7. Customer profitability analysis	3 93%
8. Estimates and plans for the number of employees	3 93%
9. Cash flow statement for the financial year	3 93%
10. Monthly purchasing forecasts or budgets	3 93%
11. Annual purchasing forecasts or budgets	3 93%
12. Calculations based on activity-based costing (selling, purchasing, delivering, etc.)	3 93%
13. Calculations of customer costs	3 93%
14. Pricing based on variable costing and contribution margin	3 93%
15. Analysis and forecasts of customer's value-added	3 93%
16. Fund flow statements of the financial year describing sources and uses of earnings and capital	4 91%
17. Calculations and analysis of financial risks	4 91%
18. Weekly forecasts or budgets for sources and uses of cash	4 91%
19. Monthly or quarterly budgets of cash flows	4 91%
20. Monthly sales forecasts or budgets	4 91%
21. Annual sales forecasts or budgets	4 91%
22. Customer analysis (satisfaction, behavior, etc.)	4 91%
23. Reports and analysis of innovation and development	4 91%
Relative Moderate Adoption	
1. Budget follow-ups, at least quarterly, and variance analysis	5 89%
2. Project follow-ups and reports	5 89%
3. Budgets for the firm's capital structure (equity and liabilities)	5 89%
4. Calculations of product or service-level costs	5 89%
5. Calculations for cost centers	5 89%
6. Product life-cycle analysis (all costs from product development to the end of production and exit from markets)	5 89%
7. Competitor analysis and forecasts	5 89%
8. Analysis and scenarios for the development of the external business environment	5 89%
9. Analysis and scenarios for alternative strategies	5 89%
10. Reports relating to the alternatives for production/operation processes	6 87%
11. Calculations based on target costing (price and target profit are known, so planning is used for reaching allowed producing costs)	6 87%
12. Long-run budgets (for example, including 2-5 years)	6 87%

13. Monthly or quarterly income statements excluding determination of depreciation and change in stock	7	85%
14. Monthly or quarterly income statements, including determination of depreciation and change in stock	7	85%
15. The efficiency of analysis of production and operations (levels of action, lead times, labor hours, delivery, etc.)	7	85%
16. Calculations of project costs	7	85%
17. Analysis of working capital and its parts (stocks, debtors, creditors), including use of ratios	8	83%
18. Follow-ups of investments with calculations and analysis	8	83%
19. Analysis of alternative capital investment possibilities for the firm's asset holdings	8	83%
20. Analysis of buy-or-make/produce alternatives	8	83%
21. Market surveys and other marketing reports alike	8	83%
22. Calculations of quality costs (for example, failures and their prevention)	8	83%
23. Benchmarking reports and analysis (for example, comparisons to a respective top firm for learning purposes)	8	83%
24. Value chain analysis	8	83%
Relative Low Adoption		
1. Use of financial ratios in the analysis of profitability, leverage, and liquidity	9	80%
2. Evaluation of the effects of investment proposals on the future economic development of the firm	9	80%
3. Market share analysis and forecasts	9	80%
4. Comparisons of financial ratios to industry averages and competitors' ratios	10	78%
5. Calculations of investment proposals over their lifetime also including economic evaluation of alternative proposals (using methods like net present value, annuity, or	10	78%
6. Calculations of environmental costs	10	78%
7. Business partner analysis and reports	10	78%
8. Shareholder value analysis/EVA	11	76%
9. Reports about non-financial arguments and criteria for investment proposals.	12	74%

The survey discloses that owners/managers of SMEs supplement financial information with qualitative information about customers and the market, just as planning and evaluation for the future. The survey supports the previous results that traditional financial practices have a prevailing importance and the expanding significance of the new meters next to the conventional ones (Ahmad & Mohamed Zabri, 2016; Reid & Smith, 2000; Rufino, 2013).

The survey result agrees with the study of Shields and Shelleman (2016) among 55 micro-SMEs in the United States, wherein these enterprises utilize numerous components of management accounting systems to aid in decision-making. These incorporate the calculation of product/service profitability, making a move on examination of actual to budgeted performance, and appraisal of client profitability.

Monthly or quarterly income statements ranked only seventh in the adoption compared to cash flow reports ranked number 3. This shows that SMEs prefer to monitor the sources and usage of cash rather than monitoring the arbitrary reports on the inflows and outflows of their operations. For the SMEs, cash is the most important being the lifeblood of the business (Ahmad & Mohamed Zabri, 2016).

Many respondents had not implemented variable costing in their business activities, with an adoption rank of only fourth. Respondents performed full absorption costing (ranked 1) contrary

to variable costing. Similarly, respondents have a minimal implementation of Activity-based Costing (ABC) (ranked third) since this tool involves significant expense, time, and complex cycles (Ahmad & Mohamed Zabri, 2016).

Studied SMEs appear not to be anxious adopters of practices geared towards planning as they have practices on traditional financial and contemporary non-financial performance measurement and monitoring. In this light, SMEs in Misamis Occidental focus more on short-term planning than formal long-range planning and performance measurement. Nonetheless, given the adoption rates of 74% or more, results show that SMEs utilize strategic-oriented practices and information for long-range planning. This supports the study of (Baird & Orris, 1994), wherein SMEs show a growing adoption rate of formal strategic planning.

Overall, the table shows that SMEs in Misamis Occidental have adopted at a high rate the 56 items about the different MCS practices and information – both the traditional and the more as of late created MCS.

Table 2 revealed that SME respondents, on average, utilize 38 various MCS practices (at least sometimes to very often or efficiently embedded into their ordinary activities, those whose mean is two or more). Conversely, a marginal of the proposed MCS practices and information, 18 items, are utilized meagerly (mean below 2). In this light, the study shows that SMEs have incorporated financial accounting practices in their MCS practices and the other categories of MCS.

Table 2. Descriptive Statistics for The Use of Mcs Practices and Information

n = 46	Mean	SD	Adoption Rank
High Use Means more than 2.50			
1. Cash flow statement for the financial year	2.85	1.32	3
2. Monthly purchasing forecasts or budgets	2.85	1.05	3
3. Personnel analysis (performance, satisfaction, etc.)	2.83	1.1	2
4. Annual purchasing forecasts or budget set al.	2.8	1.09	3
5. Pricing based on the full-costing approach	2.74	1.26	1
6. Customer analysis (satisfaction, behavior, etc.)	2.74	1.2	4
7. Monthly or quarterly budgets of cash flows	2.7	1.36	4
8. Analysis of business strengths and weaknesses, etc.	2.67	1.1	2
9. Pricing based on variable costing and contribution margin	2.65	1.29	3
10. Budgets (annual, flexible, or rolling)	2.61	1.26	3
11. Monthly sales forecasts or budgets	2.61	1.22	4
12. Annual sales forecasts or budgets	2.57	1.22	4
13. Analysis and forecasts of customer's value-added	2.57	1.13	3
14. Customer profitability analysis	2.52	1.26	3
15. Calculations based on activity-based costing (selling, purchasing, delivering, etc.)	2.52	1.33	3
Moderate Use Mean more than 2.0			
1. Calculations for cost centers	2.5	1.31	5
2. Weekly forecasts or budgets for sources and uses of cash	2.48	1.36	4
3. Calculations of product or service-level costs	2.48	1.33	5
4. Product and service profitability analysis	2.46	1.26	3
5. Estimates and plans for the number of employees	2.37	1.18	3
6. Calculations of customer costs	2.37	1.2	3
7. Calculations and analysis of financial risks	2.35	1.21	4
8. Reports and analysis of innovation and development	2.35	1.14	4
9. Analysis and scenarios for alternative strategies	2.33	1.14	5

10. Budget follow-ups, at least quarterly, and variance analysis	2.28	1.21	5
11. Calculations based on target costing (price and target profit are known, so planning is used for reaching allowed producing costs)	2.28	1.33	6
12. Analysis and scenarios for the development of the external business environment	2.28	1.21	5
13. Quality improvement analysis	2.26	1.1	2
14. Product life-cycle analysis (all costs from product development to the end of production and exit from markets)	2.26	1.26	5
15. Calculations of quality costs (for example, failures and their prevention)	2.2	1.42	8
16. The efficiency of analysis of production and operations (levels of action, lead times, labor hours, delivery, etc.)	2.17	1.34	7
17. Budgets for the firm's capital structure (equity and liabilities)	2.17	1.1	5
18. Calculations of project costs	2.17	1.31	7
19. Fund flow statements of the financial year describing sources and uses of earnings and capital	2.15	1.12	4
20. Project follow-ups and reports	2.11	1.27	5
21. Analysis of alternative capital investment possibilities for the firm's asset holdings	2.07	1.31	8
22. Value chain analysis	2.04	1.28	8
23. Competitor analysis and forecasts	2	1.2	5

Very Seldom Used Mean less than 2.0

1. Monthly or quarterly income statements excluding determination of depreciation and change in stock	1.98	1.31	7
2. Market surveys and other marketing reports alike	1.98	1.34	8
3. Long-run budgets (for example, including 2-5 years)	1.89	1.18	6
4. Calculations of environmental costs	1.87	1.36	10
5. Analysis of working capital and its parts (stocks, debtors, creditors), including the use of ratios	1.85	1.26	8
6. Use of financial ratios in the analysis of profitability, leverage, and liquidity	1.85	1.26	9
7. Follow-ups of investments with calculations and analysis	1.85	1.23	8
8. Analysis of buy-or-make/produce alternatives	1.85	1.33	8
9. Monthly or quarterly income statements, including determination of depreciation and change in stock	1.83	1.24	7
10. Market share analysis and forecasts	1.83	1.2	9
11. Business partner analysis and reports	1.83	1.36	10
12. Reports relating to the alternatives for production/operation processes	1.76	1.16	6
13. Benchmarking reports and analysis (for example, comparisons to a respective top firm for learning purposes)	1.7	1.23	8
14. Evaluation of the effects of investment proposals on the future economic development of the firm	1.67	1.28	9
15. Comparisons of financial ratios to industry averages and competitors' ratios	1.65	1.27	10
16. Calculations of investment proposals over their lifetime also including economic evaluation of alternative proposals	1.65	1.2	10

17. Shareholder value analysis/EVA	1.52	1.17	11
18. Reports about non-financial arguments and criteria for investment proposals.	1.3	1.1	12

The usage rates with the adoption ranks seem to give more significant importance to the commitment of SMEs to utilize MCS practices. The table shows that 15 MCS practices are highly adopted and used. The results also show six highly used items pertain to traditional financial management practices. Cash flow, purchases, and sales budgets are among the top in the high usage. This indicates that traditional MCS's appreciation is greater than sophisticated MCS's. This result conforms with the result of [Ahmad and Mohamed Zabri \(2016\)](#). [Davila and Foster \(2006\)](#) also concluded that budgets, cashflows, and sales projections are the first management control instruments implemented in a business.

The table also reflects that eight items ranked as relatively high adoption were classified in the group of moderate adoption. These items are: 1) weekly forecasts or budgets for sources and uses of cash (ranked 4); 2) product and service profitability analysis (ranked 3); 3) estimates and plans for the number of employees (ranked 3); 4) calculations for customer costs (ranked 3); 5) calculations and analysis of financial risks (ranked 4); 6) reports and analysis of innovation and development (ranked 4); 7) quality improvement analysis (ranked 2); and 8) fund flow statements of the financial year describing sources and use of earnings and capital (ranked 4).

Four of the items above belong to the category of traditional MCS, while the remaining four belong to the new categories of MCS. Though many establishments utilize the practice, it can be inferred that they are implemented irregularly instead of methodically embedded as part of ordinary activities. The remaining moderately used MCS practices and information inclined to focus on qualitative information and practices emphasizing quality, workforce, and production processes ([Chenhall & Langfield-Smith, 1998](#)).

The third group of low-use consists of 18 items. The table reveals that the low adoption is supported by the low usage by the SMEs of the mentioned MCS practices and information except for "follow-ups of investments with calculations and analysis" that originally belonged to the relatively moderate adoption (ranked 8). Reports about non-monetary contentions and standards for venture propositions consistently rated as the least used and the lowest adoption rate among SMEs. Ten items belong to the traditional MCS practices, while eight are the new ones geared towards long-range planning.

Additionally, it can be seen that SMEs seldom use financial accounting information and practices together with capital budgeting techniques. Ten of the items in the very seldom used fall into these categories, plus the "use of monthly or quarterly income statements" ($x = 1.98$) and "financial ratios" ($x = 1.85$). The SMEs under survey additionally do not appear to utilize many sophisticated techniques in their capital venture choices ($x = 1.30$) and follow-ups of investment decisions with calculations and analysis ($x = 1.85$). The remaining eight items on the list refer to the low use of SMEs of the new sophisticated practices of market surveys, long-run budgets, make or buy analysis, business partner analysis, bench-marking, and shareholder value analysis. This could indicate that the SMEs have little use for these practices and information ([Ahmad & Mohamed Zabri, 2016](#)).

Overall, SMEs do utilize MCS practices and information in their business. However, many of these practices are not integrated as highly and systematically into their normal operations, as shown by the adoption rate and rank data. Furthermore, traditional financial MCS practices and information appear to rule the high adoption and usage among the SMEs under study. However, it is notable that SMEs in Misamis Occidental are adopting and utilizing the new sophisticated and planning-oriented strategic practices, even if they are not so firmly incorporated into most organizations' precise utilization.

4 CONCLUSION

This study was conducted to understand the MCS SMEs in Misamis Occidental adopt and use in their operations, whether traditional or the new sophisticated and planning-oriented strategic practices. It also aimed at complementing past research regarding MCS in SMEs, which had previously been neglected.

Tentatively, it can be resolved that the MCS orientation in SMEs in Misamis Occidental is themed along the lines of financial, customer, relationship, and strategic-oriented controls. This shows a combination of traditional MCS and new sophisticated MCS, which add to the knowledge that SMEs practice and adopt MCS in their operations.

To summarize, this work has given data on the use of MCS among SMEs in Misamis Occidental. The data can be used as a base for additional scholarly examination in business. Research can be done on the themes of MCS and strategic planning, management control systems adoption challenges and difficulties, and whether owner/manager generation affects the adoption and practice of MCS in SMEs. These results additionally show that aside from designing MCS suited to SMEs, there is a need to guide them in the technical application, adoption, and utilization of MCS data.

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