



Management control system design, ownership, and performance in professional service organisations



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ABSTRACT

The objective of this study is to investigate the implications for organisational performance of the interplay between ownership and management control system design in professional service organisations. Based on transaction cost economic (TCE) theory, we expect that low ownership by professionals working in a professional services organisation will be more efficiently managed with a boundary MCS archetype and high ownership by an exploratory MCS archetype. Of direct relevance, we predict that a failure to conform to these optimal archetypes will manifest in relatively poorer performance. The study was conducted based on a survey of 120 practice managers of primary healthcare organisations in Australia. These results provide empirical support for the stated prediction.

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1. Introduction

We investigate the implications for organisational performance of the interplay between ownership and management control system (MCS) design in professional service organisations. The contextual setting for our investigation is the primary healthcare sector in Australia. Primary healthcare organisations (PHOs) are small ‘for profit’ organisations where general practitioners (GPs) provide a first point of contact with the healthcare system (DHA, 2013). PHOs present a considerable control challenge because GPs are highly trained professionals who work independently to produce an intangible output and have preferences that conflict with bureaucracy. Early organisational theorists predict that ownership is an effective solution to this challenge (Fama & Jensen, 1983; Greenwood & Empson, 2003).² However, in Australia we observe differences in the level of GP ownership across PHOs (IBIS, 2011). The performance implications of this variation have not been investigated to date. A related question is whether differences in the MCS design can mitigate these differences.

We structure our analysis around Transaction Cost Economics (TCE), a holistic MCS design theory that allows for the possibility

of misalignment and resultant performance effects (Hakansson & Lind, 2007). We argue, consistent with Speklé (2001), that within the PHO context which exhibits the characteristics of high uncertainty and high asset specificity, the efficient MCS design for organisations with low GP ownership is the boundary archetype and for those with high GP ownership, it is the exploratory archetype. The boundary archetype features administrative controls emphasising behaviours to be avoided whereas the exploratory archetype features less formal controls that are engaged in creating and preserving information sharing. Importantly, we predict that conforming to these archetypes will result in relatively higher performance (Speklé, 2001).

We employ data from an online survey of practice managers that provided 120 useable responses (a 26.6% response rate). We identify the empirical ideal MCS for PHOs that differ in ownership via a two-stage cluster analysis using percentage of ownership and MCS effectiveness (Gerdin, 2005). We measure fit as the Euclidean distance of the organisation’s MCS profile from its empirical ideal MCS based on the top performing organisations within the cluster. Since TCE predicts the most efficient MCS given ownership, we measure performance as financial performance relative to peers. The results support our prediction of a positive relationship between fit and organisational performance. Sensitivity analyses using an objective measure of performance based on gross fee revenue and using fit measured relative to the cluster average MCS profile reveal results to be robust to the choice of performance measure and choice of benchmark to define the ideal MCS design. As a by-product, we also find the organisations that self-assess as

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¹ This study is based on Robyn King’s PhD thesis completed in the UQ Business School at the University of Queensland.

² Limiting conditions are scale, complexity, capital intensity, commodification, litigation and social trends (Greenwood & Empson, 2003).

having effective MCS conform with [Speklé's \(2001\)](#) theoretical ideal ownership-archetype profiles whereas those that reported an ineffective MCS do not.

Our study extends the MCS literature by investigating ownership as a relevant contextual variable when evaluating the impact of MCS design on performance. Our evidence indicates that there are different optimal combinations of GP ownership and MCS design with similar financial performance outcomes, consistent with the concept of equifinality ([Gresov & Drazin, 1997](#)). Our findings also contribute to the ongoing debate about the suitability of TCE as a holistic theory of MCS design ([Speklé, 2001](#)). From a practical perspective, our evidence has the potential to assist managers, owners and advisors optimise MCS design for the organisation's given level of ownership. While we conduct our study within the context of the Australian primary healthcare sector given its economic and social significance and the significance of the control problem within this sector, our results are applicable more broadly. Similarities among the primary healthcare sectors in Australia, the U.K., and the U.S. make our findings of interest internationally. Further, since the conceptual foundation of our study is not restricted to one particular context, our findings are also applicable to other professional service sectors.

The remainder of this study is organised as follows. We next discuss the literature on ownership and MCS design in professional services organisations, and describe the Primary Healthcare sector in Australia. The third section develops our hypothesis, and the fourth section describes our research design and sample data. The fifth section reports our results and the sixth section concludes.

2. Control in the professional services sector

2.1. The role of ownership in professional service organisations

Early organisational theorists propose ownership as the ideal control solution for professional service organisations. As owners, professionals will have the residual rights to control and the incentive to make decisions that will create, maintain and improve the organisation ([Hansmann, 1996](#)). Ownership also reduces the likelihood of the professional leaving and is a form of cultural control that encourages mutual monitoring ([Merchant & Van der Stede, 2007](#)). Consistent with this view, [Greenwood, Deephouse, and Li \(2007\)](#) compare the performance of large management consultancies and find that private corporations and partnerships outperform public corporations.

If these predictions and findings hold, we would expect to see all professional service organisations owned by the professionals working in them.³ However, there are two arguments as to why, in practice, ownership rights may represent an incomplete solution to their control challenge. First, a necessary condition for ownership to develop as a complete solution is a stable regulatory and institutional setting ([Mintzberg, 1979](#)). In a dynamic environment, efficient ownership may not be quickly achieved due to the long term nature of the ownership arrangements, limits to the cognitive abilities of the contracting parties, and the costs of changing arrangements ([Richter & Schroder, 2008](#)). Further, if the industry is, in some sense, relatively immature, ownership measured at a point in time can be considered as exogenous ([Larcker & Rusticus, 2007](#)).

³ There is some evidence of clustering of ownership structures. In a professional services setting, [Richter and Schroder \(2008\)](#) find size, service standardisation, capital requirements and risk to be determinants of ownership, and conclude that it is a combination of these factors that determines the optimal allocation of ownership rights. There are two provisos. First, the difficulty in raising capital and the limited capacity of employees to absorb risk pose limits to internal ownership. Second, internal ownership constrains the size of firms.

Second, even given a stable setting, there are a number of limiting factors at the organisational level. These factors include differences in the amount of capital the individual owners can provide, their requirements for division of returns, and their priorities including profit generation, employment security and working time ([Greenwood & Empson, 2003](#)). Due to these differences, there will be varying degrees of alignment between personal and organisational goals, leaving a residual control problem ([Ittner, Larcker, & Pizzini, 2007](#)). With diffused ownership, there also is the possibility of shirking ([Gaynor & Gertler, 1995](#)), as well as the need to co-ordinate decision-making among multiple owners and to control individual activities to achieve efficient outcomes. As a result, [Richter and Schroder \(2008\)](#) propose that internal governance, specifically MCS design, can augment ownership to arrive at a more complete control solution.

Following [Richter and Schroder \(2008\)](#) and [Empson and Chapman \(2006\)](#), we propose a role for the MCS as part of the control solution. If due to constant changes in the environment, ownership is not yet in equilibrium, there should be variation not only in the observable ownership but also in MCS design. In circumstances where ownership is in some sense sub-optimal, the manager can more readily adjust the MCS design to achieve efficient performance. Of direct relevance, if the MCS is designed in such a way that it is optimal for the level of ownership, taken together ownership and the MCS should reduce overall control costs and enhance organisational performance. There is some evidence that professional partnerships and public corporations can be equally effective if systems and structures are suitably constructed, with the caveat that members must be strongly committed to the professional interpretive scheme ([Empson & Chapman, 2006](#)). There is also the possibility that a mismatch between the MCS design and ownership might occur in the short run with negative performance implications ([Empson & Chapman, 2006](#)).

2.2. Primary healthcare

The Australian health and aged care sector represents one-tenth of the economy and is predicted to grow to one-eighth in the next twenty years ([NHHRC, 2009](#)). There is universal health coverage with one main funding body, Medicare. The GP is the first point of contact for a majority of patients, providing 88% of their required care and is the recognised "gatekeeper" as a referral is required to access specialist, secondary and tertiary care ([IBIS, 2011](#)). GPs work primarily in small privately held PHOs that employ nurses, administrators and increasingly practice managers ([DHA, 2005](#)). Over the last two decades, PHOs have grown from a majority having one or two GPs in 1994, to a majority having five or more in 2010–2011 ([AIHW, 2012](#)). Since 1998, there has been a shift towards corporate ownership by publicly listed companies that currently have 12% of the market, and approximately 72% of GPs now work in PHOs they do not own ([Kron, 2012](#)). Payment is mostly on a fee-for-service basis, although since 2000 there has been an increase in blended payments known as Practice Incentive Payments (PIPs). PIPs are a group reward for PHOs that require collective action of their GPs and represent 9% of income ([ANAO, 2010](#)). To receive PIPs, PHOs must be accredited to Royal Australian College of General Practice (RACGP) standards every three years and meet the requirements of the thirteen PIP categories ([DHS, 2011](#)).⁴

⁴ The RACGP standards for general practice cover five areas: practice services; rights and needs of patients; safety, quality and improvement; practice management; and physical factors ([RACGP, 2011](#)). The amount of the PIP is based on the number of full time equivalent GPs, whole patient equivalents and the meeting of a number of performance measurement targets such as delivery of after-hours care, the use of information technology, teaching, rurality, preventative services for at risk patients, and quality prescribing habits.

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