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Management Control Systems Practices in Nepalese Commercial Banks

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Abstract

This study examines the impact of management control systems on the perceived performance of Nepalese commercial banks, focusing on key components such as budgeting, risk assessment, monitoring and supervision, information and communication, and the control environment. Employing a descriptive and causal research design, data were collected from 371 managers and employees across seven banks in Kathmandu using a structured questionnaire. The analysis, conducted through SPSS, utilized descriptive statistics, correlation, and regression models to assess the relationship between study variables. The findings reveal that a robust control environment and effective monitoring significantly enhance perceived performance, highlighting the critical role of management control systems components in achieving strategic alignment and operational efficiency within the sector. The study underscores the need for targeted managerial development and the integration of comprehensive management control systems frameworks to meet regulatory requirements and drive sustainable growth in Nepal's banking industry.

Keywords: management control systems, perceived performance, Nepalese commercial banks, control environment, operational efficiency

JEL Classification: M41, G21, M48, L21, G34

Introduction

Management Control Systems (MCS) are pivotal in aligning organizational operations with strategic goals, particularly in the banking sector, where the stakes involve both financial stability and customer trust. In Nepal, the adoption of sophisticated MCS has become increasingly essential as the financial sector has grown more complex and competitive. Historically, Nepalese banks operated with basic control mechanisms, but the liberalization of the financial sector in the 1990s, coupled with the entry of foreign banks, necessitated a shift towards more advanced MCS to enhance operational efficiency and manage risks effectively (Dhungana, 2021). This transition is critical not

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only for improving internal processes but also for meeting the stringent regulatory requirements imposed by the Nepal Rastra Bank (NRB) (Adhikari, 2023).

The implementation of MCS in Nepalese banks has been shown to directly influence their financial performance. For instance, banks with robust MCS frameworks tend to report higher profitability, better asset quality, and enhanced customer satisfaction (Shrestha, 2022). These systems help in setting clear performance targets, monitoring outcomes, and ensuring that corrective actions are taken when deviations occur. Additionally, MCS are integral to risk management strategies, allowing banks to identify, assess, and mitigate various types of risks, including credit, market, and operational risks (Poudel, 2023). The internal audit function, a key component of MCS, plays a significant role in this context by providing independent evaluations of the bank's risk management practices and ensuring compliance with internal policies and regulatory standards (Rana, 2023).

However, the adoption of MCS in Nepalese commercial banks is not without challenges. A significant barrier is the shortage of skilled personnel with expertise in MCS, which hampers the effective implementation and utilization of these systems (Shah, 2023). Additionally, resistance to change, particularly among senior management, and the high costs associated with implementing advanced MCS technologies pose further obstacles (Thapa, 2023). Despite these challenges, the future of MCS in Nepalese banks remains promising. Continued investment in employee training, coupled with efforts to foster an organizational culture that embraces MCS, is essential for overcoming these hurdles and ensuring that banks can fully leverage the benefits of effective MCS (Rai, 2024).

Despite recognized importance of MCS, many banks still rely on basic control mechanisms, making it difficult to meet regulatory requirements imposed by NRB (Adhikari, 2023; Dhungana, 2021). Although robust MCS frameworks have been linked to higher profitability and improved asset quality (Poudel, 2023; Shrestha, 2022), barriers such as a shortage of skilled personnel, resistance to change, and high implementation costs hinder their adoption (Shah, 2023; Thapa, 2023). The internal audit function, essential for risk management and compliance, is not fully integrated into the MCS framework in many banks (Rana, 2023). While the future of MCS in Nepalese banks shows promise, significant hurdles in training, organizational culture, and technology adoption must be addressed to fully leverage the benefits of MCS (Rai, 2024).

Studying MCS in Nepalese commercial banks is vital as it enhances performance, improves risk management, and ensures regulatory compliance. Effective MCS practices drive operational efficiency, facilitate benchmarking, and boost employee performance. They provide critical decision-making information and support growth in a dynamic sector. This study aims to assess how key MCS budgeting practices, risk assessment, monitoring and supervision, information and communication, and the control environment impact the perceived performance of Nepalese commercial banks. It will analyze the influence of each component on overall performance and explore the relationships between these practices and their combined effect on operational efficiency and strategic alignment in the sector. This research also adds valuable insights to academic literature and guides scholars, practitioners, and policymakers in developing countries.

Literature Review

MCS are crucial for organizations to achieve their strategic objectives by ensuring that various activities are directed towards these goals. MCS can be defined as a system, process, or structure used to influence the behavior of employees and ensure that organizational goals are achieved efficiently and effectively (Chenhall, 2023). These are crucial for organizations to achieve their strategic objectives by ensuring that various activities are directed towards these goals.

In the banking sector, MCS plays a pivotal role in ensuring regulatory compliance, managing financial performance, and achieving strategic goals. Commercial banks utilize MCS to manage risk, enhance performance, and meet regulatory requirements" (Kong, 2022).

Theoretical Review of MCS

Agency Theory. Agency Theory, introduced by Jensen and Meckling (1976), posits that MCS are instrumental in addressing conflicts between managers (agents) and shareholders (principals). These conflicts arise due to differing goals and the asymmetry of information. The theory suggests that MCS help to align managerial actions with the interests of shareholders. By implementing reporting and monitoring systems, MCS reduce the information gap between managers and shareholders, facilitating better oversight (Eisenhardt, 1989). Performance-based compensation and bonuses linked to financial metrics can motivate managers to act in the shareholders' best interest (Holmström, 1979).

Contingency Theory. Contingency Theory, developed by Otley (1980), suggests that the effectiveness of MCS is influenced by the specific context within which an organization operates. The design and implementation of MCS should align with both external and internal factors. These include market conditions, competition, and regulatory environments. MCS must be adaptable to the organization’s internal environment to ensure they support strategic objectives effectively (Fisher, 1998).

Institutional Theory. Institutional Theory emphasizes the role of external pressures and norms in shaping organizational practices. This theory posits that organizations are influenced by external forces such as regulations, industry standards, and social expectations, which affect how they design and implement their MCS (DiMaggio & Powell, 1983). Regulatory requirements are a major external pressure influencing MCS practices in banks. Compliance with financial regulations, such as Basel III for capital adequacy and liquidity, shapes how banks develop their internal controls and reporting systems. Regulatory bodies impose standards that compel banks to adopt specific MCS practices to ensure transparency and accountability (Carnegie & Napier, 2022). Industry standards and norms also play a critical role. Banks are often guided by best practices established within the industry, which influence their MCS. These standards ensure that banks maintain operational consistency and meet the expectations of stakeholders (Greenwood & Suddaby, 2016). Social expectations and pressures from stakeholders, including customers, investors, and the public, affect MCS. Banks are increasingly expected to adopt ethical practices and demonstrate corporate social responsibility, which influences their control systems (Lynch & Smith, 2021). Institutional isomorphism refers to the process by which organizations become similar to each other over time due to external pressures. In the banking sector, this results in a convergence of MCS practices as banks adapt to similar regulatory and industry pressures (Powell & DiMaggio, 1983). The dynamic nature of the banking environment, including changes in technology and financial markets, further influences MCS practices and thus banks must continuously adapt their MCS to address emerging challenges and opportunities (Brown & Wang, 2023).

Empirical Review

Perceived Performance. Establishing clear performance metrics helps in assessing the effectiveness of MCS and aligning them with organizational objectives (Krause & Turner, 2023). Understanding stakeholder perceptions of MCS effectiveness provides insights into its impact on organizational goals (Miller & Zhao, 2023) and performance. (Harris & Yang, 2022). Gathering feedback from employees helps in evaluating the perceived effectiveness of MCS and identifying areas for improvement (Smith & Lee, 2022). Comparing perceived performance against industry benchmarks helps in evaluating the relative effectiveness of MCS (Brown & Wilson, 2023).

Budgeting. Budgeting is closely linked to strategic planning, helping organizations align their financial resources with strategic goals. Effective budgeting processes support long-term planning and resource allocation (Lueg, 2022). Involving employees in the budgeting process can improve motivation and accuracy. Participative budgeting engages various levels of the organization in setting and reviewing budgets (Sharma & Ghosh, 2021). Implementing budgetary controls allows organizations to monitor financial performance against budgeted targets, providing insights into variances and enabling corrective actions (Gordon & Miller, 2023). Flexible budgeting adjusts budgets based on changes in activity levels, providing more accurate and relevant financial information for decision-making (Yang & Kim, 2023). Analyzing budget variances helps organizations understand the reasons behind deviations and make informed decisions to address them (Jones et al., 2022). Rolling budgets provide continuous updating of budgets, allowing organizations to adapt to changing conditions and maintain relevance (Anderson & Williams, 2022). Accordingly, the following hypothesis has been developed:

H1: Budgeting has a significant impact on perceived performance.

Control Environment. Effective leadership and a strong ethical culture are fundamental to creating a positive control environment. Leaders set the tone for organizational behavior and compliance (Krause et al., 2023). A well-defined organizational structure supports the control environment by clarifying roles, responsibilities, and reporting lines (Miller & O'Reilly, 2022). Human resource policies contribute to the effectiveness of the control environment (Williams & Lee, 2023). The commitment of top management to maintaining a strong control environment is essential for its success (Chen et al., 2022). Implementing a robust internal control framework helps in creating an effective control environment, ensuring compliance and risk management (Johnson & Brown, 2023). Regular communication of organizational values and expectations helps reinforce the control environment (Davies & Clark, 2022). Similarly, following statement has been hypothesized for the study:

H5: Control environment has a significant impact on perceived performance.

Monitoring and Supervision. Regular internal audits help in evaluating the effectiveness of control systems and identifying areas for improvement (Walker & Stevens, 2023). Conducting performance reviews helps in assessing individual and departmental contributions to organizational goals (Smith & Adams, 2022). Monitoring compliance with policies and regulations ensures adherence to legal and organizational standards (Miller & Johnson, 2022). Effective supervisory practices contribute to the proper implementation and functioning of control systems (Jones & Kim, 2023). Monitoring systems should be designed to promote continuous improvement and adaptation to changing conditions (Wilson & Clark, 2023). Implementing exception reporting helps in identifying and addressing deviations from expected performance

(Davis & Roberts, 2022). Based on the literature, hypothesis in relation of monitoring and supervision with perceived performance has been developed as follows:

H3: Monitoring and supervision have a significant impact on perceived performance.

Risk Assessment. Identifying potential risks is the first step in the risk assessment process, allowing organizations to focus on significant threats (Smith & Lee, 2023). Evaluating the likelihood and impact of identified risks helps prioritize them and allocate resources effectively (Brown & Zhao, 2022). Developing and implementing risk mitigation strategies helps in managing and reducing the impact of identified risks (Taylor & Wright, 2023). Effective risk communication ensures that relevant stakeholders are aware of potential risks and mitigation measures (Wilson & Roberts, 2022). Integrating risk assessment with strategic planning helps align risk management efforts with organizational goals. Similarly, this study intends to test the following hypothesis.

H2: Risk assessment has a significant impact on perceived performance.

Information and Communication. Clear communication channels ensure that relevant information is shared efficiently across the organization (Brown & Patel, 2023). Effective information systems (Harris & Chen, 2022) along with data accuracy and integrity (Gordon & Wang, 2022) is crucial for reliable reporting support timely and accurate reporting, decision-making and control. Establishing effective reporting mechanisms helps in monitoring performance and addressing issues in a timely manner (Lee & Brown, 2023). Implementing feedback systems allows for the continuous improvement of information and communication processes (Roberts & Davis, 2023). In line with the literature, this study hypothesized as follows:

H4: Information and communication has a significant impact on perceived performance.

Method

The research design for this study incorporates both descriptive and causal elements to thoroughly investigate MCS practice in terms of budgeting, risk assessment, monitoring and supervision, information and communication, and controlling environment and its effect on perceived performance of Nepalese commercial banks, with a particular focus on seven banks in the Kathmandu district. A purposive sampling method was employed to target middle-level managers, ensuring that the sample accurately reflects the population under examination. Data were collected through meticulously crafted questionnaires, distributed to 700 managers, senior-level employees, mid-level employees, and entry-level employees, achieving a 53% response rate with 371 completed surveys. The questionnaire, designed based on a review of existing literature and conceptual frameworks, was divided into two sections: one focusing on demographic and operational characteristics, and the other evaluating the impact of MCS on bank performance. Respondents provided their input using a Likert scale to indicate their level of agreement with various statements. For data analysis, both descriptive and causal statistical techniques were utilized through SPSS software. This analysis included the use of mean values, standard deviations, and regression models to interpret the data, which was then organized into tables and figures.

Results

The demographic data from 371 respondents in the banking sector reveals key insights into the workforce composition and perceptions regarding MCS. The majority (66%) of respondents are male. Most respondents are relatively young, with 49.1% aged between 18-25 years and 45.3% between 26-35 years, while only 5.7% are in the 36-45 age range, and none are above 46 years. Educationally, a significant majority hold a Master's degree (58.5%), followed by those with a Bachelor's degree (39.6%), and a small fraction have a High School qualification (1.9%). No respondents possess a Doctorate. In terms of job positions, most are entry-level employees (56.6%), followed by middle-level managers (39.6%), with a small proportion being senior-level managers (3.8%). No respondents are in executive or top management positions.

The descriptive analysis of MCS practices shows a generally positive perception among respondents. The budgeting process is well-regarded, with high ratings for alignment with strategic goals (mean = 3.85), resource allocation (mean = 3.83), adaptability (mean = 3.84), use of KPIs (mean = 4.27), and employee participation (mean = 3.79). Risk assessment practices also receive favorable feedback, with strong scores for systematic risk identification (mean = 3.85), updating processes (mean = 3.94), and mitigation controls (mean = 3.75). Monitoring and supervision practices are similarly viewed positively, particularly the structured performance evaluation system (mean = 3.83), periodic internal audits (mean = 4.00), and management oversight (mean = 3.94), though feedback provision (mean = 3.60) shows some variability. Information and communication practices are rated positively overall, with robust information systems (mean = 3.87) and effective communication of goals (mean = 3.74), though encouragement of employee ideas (mean = 3.49) is rated lower. The control environment also receives positive feedback, with high ratings for ethical culture (mean = 3.75), leadership (mean = 3.66), and a positive work environment (mean = 3.91). Lastly, the MCS is perceived favorably in terms of achieving organizational goals (mean = 3.77), providing timely information (mean = 3.91), and promoting accountability (mean = 3.96).

The comprehensive analysis of these practices highlights strengths and areas for potential improvement, offering a detailed view of current MCS effectiveness within the banking sector in Nepal.

Correlation Analysis

The correlation analysis (Table 1) reveals strong, positive relationships between all independent variables (budgeting, control environment, information & communication, monitoring and supervision, and risk assessment) and perceived performance.

Table 1
Correlation Analysis

	Budg.	Control Env.	Info. & Comm.	Mon. & Sup.	Risk Ass.	Perc. Perf.
Budg.	1					
Control Env.	.678**	1				
Info. & Comm.	.701**	.821**	1			
Mon. & Sup.	.665**	.852**	.795**	1		
Risk Ass.	.696**	.681**	.619**	.649**	1	
Perc. Perf.	.648**	.848**	.777**	.815**	.680**	1

**. Correlation is significant at the 0.01 level (2-tailed).

The control environment exhibits the highest correlation with perceived performance ($r = 0.848$, $p < 0.001$), followed closely by monitoring and supervision ($r = 0.815$, $p < 0.001$). Information & communication ($r = 0.777$, $p < 0.001$) and budgeting ($r = 0.648$, $p < 0.001$) also show significant positive correlations, while risk assessment ($r = 0.680$, $p < 0.001$) has a moderately strong relationship. These findings suggest that improvements in these factors are closely linked to enhancements in perceived performance.

Regression Analysis

The regression analysis assesses how well budgeting, control environment, information & communication, monitoring and supervision, and risk assessment predict perceived performance. The regression result (Table 2) presents a strong model fit, with an Adjusted R Square of 0.769, indicating that approximately 76.9% of the variance in perceived performance is explained by the independent variables. The significant F-value of 247.781 ($p = 0.000$) further underscores the model's robustness. Among these variables, the control environment has the most substantial impact (Beta = 0.416, $p < 0.001$), followed by monitoring and supervision (Beta = 0.208, $p < 0.001$). This suggests that a strong control environment and effective monitoring and supervision are crucial for enhancing perceived performance. Budgeting, risk assessment, and information & communication also contribute positively, albeit to a lesser extent. The Variance Inflation Factor (VIF) values, ranging from 2.288 to 4.912, indicate that multicollinearity is within acceptable limits, ensuring reliable estimates. Overall, these findings highlight the deep impact of these factors on perceived performance.

Table 2

Coefficients Model

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	0.09	0.115		0.788	0.431		
Budg.	0.131	0.053	0.119	2.465	0.014	0.268	3.736
Control Env.	0.42	0.056	0.416	7.518	0.000	0.204	4.912
Mon. & Sup.	0.236	0.061	0.208	3.875	0.000	0.216	4.628
Risk Ass.	0.098	0.035	0.107	2.822	0.005	0.437	2.288
Info. & Comm.	0.115	0.05	0.112	2.307	0.022	0.265	3.77
Adjusted R Square = 0.769, F-Value = 247.781, Sig. = 0.000							

Hypotheses Result

Based on the regression result showed in Table 2, hypothesis testing result is summarized in Table 3.

Table 3

Hypothesis Testing Result Taking Perceived Performance as Criterion Variable

Predictor Variables	Reported Relationship	Sig at.	Decision
Budgeting	Positive	0.05	Accepted
Control Environment	Positive	0.01	Accepted
Monitoring and Supervision	Positive	0.01	Accepted
Risk Assessment	Positive	0.01	Accepted
Information and Communication	Positive	0.05	Accepted

Discussion

This study reveals robust insights into the effectiveness of MCS within Nepalese commercial banks. The demographic data highlights a predominantly young workforce with a strong educational background, yet with a significant proportion in entry-level positions. This demographic profile suggests a need for targeted development programs to enhance managerial capabilities and align with strategic goals. The descriptive statistics indicate a generally favorable view of MCS practices, with particularly high ratings for budgeting processes, monitoring and supervision, and the control environment. The positive perception of these elements underscores their importance in driving perceived performance within the banks. Further, the correlation result showed significant positive relationships between all independent variables and perceived performance, with the control environment and monitoring and supervision having the strongest correlations.

In terms of MCS practices, the positive perceptions of budgeting, monitoring, and control environments are consistent with broader literature. Merchant and Van der Stede (2019) discussed how effective budgeting processes are integral to achieving organizational goals and improving performance, similar to the high ratings observed in the study. Becker et al. (2018) highlighted the critical role of monitoring and supervision in maintaining performance standards, aligning with the study's findings on their impact. Furthermore, Chenhall (2016) emphasized that a robust control environment fosters a culture of accountability and integrity, which is mirrored in the high ratings for the control environment in the Nepalese banks. The correlation and regression analyses in the study reveal that the control environment and monitoring & supervision have the strongest influence on perceived performance. This aligns with Simons (2018), who posits that a strong control environment and effective supervision are pivotal in enhancing performance outcomes. Similarly, Brown and Cummings (2021) confirmed that robust control environments and efficient monitoring systems are crucial for improving organizational performance.

Moreover, the study's results are supported by Gordon and Miller (2022), who found that while all MCS components contribute to performance, control environment and monitoring have the most significant impact. Kaplan and Norton (2020) also asserted that these components are essential for achieving strategic objectives and enhancing overall effectiveness. The high Adjusted R Square value and significant F-statistic in the regression analysis confirm the robustness of the model, consistent with Moores and Yuen (2018), who emphasized that such metrics validate the effectiveness of MCS frameworks in organizational settings.

Conclusion

This study offers valuable insights into the MCS utilized within Nepalese commercial banks. The analysis reveals a workforce that is predominantly young and well-educated but largely concentrated in entry-level positions, need a specialized managerial training and development initiatives. The generally positive perceptions of MCS practices, particularly in budgeting, monitoring and supervision, and the control environment, underscore their importance in achieving organizational goals and enhancing overall performance. The high ratings in these areas suggest that effective implementation of these practices contributes significantly to improve performance outcomes in banking sector. The correlation and regression analyses further highlight the impact of various MCS components on perceived performance. Specifically, the control environment and monitoring and supervision are identified as the most influential factors, while budgeting, risk assessment, and information & communication also contribute positively but to a lesser extent. The strong positive correlations and the robust model fit confirm the critical role of MCS elements in performance improvements. This emphasizes the need for banks to focus on strengthening their control environments and enhancing monitoring systems to maximize organizational effectiveness.

Building on the current study's insights, several areas warrant further exploration. Longitudinal studies could shed light on how MCS practices evolve over time and their sustained impact on performance. Comparative research across different sectors or regions could highlight best practices and sector-specific challenges. Qualitative approaches, such as interviews or case studies, would provide in-depth, context-specific insights into MCS implementation and perception. Investigating the role of technological advancements in MCS, examining the link between employee perceptions and performance, and benchmarking against international standards could uncover new dimensions and opportunities for improvement. Extending research to other financial sectors in Nepal would offer a broader understanding of MCS effectiveness.

Limitations: This study faces several limitations. The cross-sectional design may not capture long-term changes in MCS. Self-reported data could introduce biases, and focusing solely on banks of a single district limits generalizability. The lack of qualitative insights means challenges in MCS implementation are less explored. Additionally, the study does not consider external factors like economic fluctuations or regulatory changes, which could affect MCS effectiveness.

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