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Management Control System in Selected Microfinance Institutions in Central Region, Uganda

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Abstract

This study was undertaken to examine the levels of Management Control system in the selected Microfinance institutions central region, Uganda. The ex post facto or retrospective, prospective designs and descriptive survey design, and specifically descriptive comparative and descriptive correlation strategies were employed. A minimum sample of 266 was used in data collection and analysis. Data was analysed using means and t-test. The findings revealed that the level of management control system in the microfinance institutions in central region Uganda is efficient with an overall mean of 3.23.The contingency theory by Joan Wood wards (1958) as cited and explained by Simons' (1995) levers of management system control model was authenticated and validated. The conclusion was drawn that the level of Management control system was generally efficient and it was recommended that Microfinance institutions should enhance, strengthen set and establish strong and effective control systems: all of the financial, operational and other control systems which are carried out by internal controllers and which involve budgeting, monitoring, independent evaluation and timely reporting to management levels systematically in order to ensure that all the institutions activities are performed by management levels in accordance with current policies, methods, instructions and limit.

Key Words

Management Control System, Microfinance , Institutions

Introduction

The Microfinance sector in Uganda is made of formal and informal microfinance finance institutions (Hanning 2000). The formal institutions are either companies which are regulated under the banking laws; financial intermediaries which are not banks but regulated by the government as Microfinance Deposit taking Institutions; non-regulated companies that offer only credits; or formally registered cooperatives and societies that serve their members. The formal institutions are members of the Association of Microfinance Institutions of Uganda.

According to the Ministry of Finance (2000), Microfinance became an issue for the Ministry of Finance and Economic Planning as well as the Bank of Uganda, as both made themselves acquainted with national and international experiences and practices. The unwillingness or inability of the formal financial institutions to provide financial services to the urban and rural poor, coupled with the un sustainability of government sponsored development financial schemes contributed to the growth of private sector-led microfinance in Uganda.

The evolution of Micro finance institutions in Uganda was a direct response to the failure of past attempts by government and donor funded rural credit programmes to reach poor families and landless households within the rural areas (Abbink 2002). Coupled with this is the fact that the small scale business people targeted by Micro finance institutions did not have the traditional collateral which is the basis for loan acquisition to the formal banking sector. The first Micro finance institutions appeared is South Asia almost twenty years ago, but have since spread to Latin America, South East Asia and more recently Africa, China, the South Pacific.

Uganda is generally seen as the country with the most vibrant and successful microfinance industry in Africa. Some microfinance institutions have experienced strong growth and are now reaching a considerable number of clients, (Bategekea 1999).

Microfinance came to be viewed as the most obvious vehicle for delivering financial services to the urban and peri-urban low-income earners as well as to the rural population (Opiokello 2000).

Access to credit is a major issue among the rural poor, and microfinance institutions, and loan schemes are designed to fulfil this demand. Such organizations often teach community members about the benefits and methods of saving, while offering micro-loans to start small businesses. Along with microfinance opportunities, socio economically excluded Ugandans need micro enterprise creation and development training to effectively utilize credit.

In times of rapid changes and increasing competition, the top management, corporate quality managers, financial controllers, and systems managers need to design Management Control Systems which help companies to achieve leading positions in terms of operational quality, productivity and financial break through. Management control is thus becoming increasingly complex across most industries (Carpenter 2000). In some cases, this increased effort seems to pay off in terms of positive financial returns. However, Microfinance Institutions show a short sustainability and weaknesses in enhanced management control practices or initiatives which seemed successful and beneficial for other industries. Microfinance institutions are expressing more emphasis on using executive ability and control system for solving management and decision issues such as cost difference analysis, performance evaluation and budget execution.

Microfinance institutions in Uganda are always often faced with high operating costs to provide financial services to the poor people and Small and Medium Enterprises (Micro banking Bulletin 1998). As more microfinance institutions grow and become formal financial institutions, each Microfinance Institution has a unique profile and operational structure that determines which types of controls are appropriate to increase financial performance.

Most Microfinance Institutions in Uganda are unable to meet their obligations when they become due usually resulting from poor cash flow planning, failure to monitor portfolio quality closely and take action when necessary. Portfolio quality has deteriorated more rapidly in Microfinance institutions than in traditional financial institutions due to the short-term and unsecured nature of micro lending, micro loan portfolios which tend to be more volatile (Ssewanyana 2009). Most Microfinance Institutions have also been experiencing financial losses due to changes in market interest rates. This has been due to lack of a good and strong Management control system (Ministry of Finance, Planning and Economic Development2000). These challenges increase transactions costs for services provided by the Microfinance Institutions.

The new vision of April 19^{th} 2002, in its micro finance Supplement noted that micro finance in Uganda though a fairly new industry is very vibrant and has seen a growth rate of over 70% per year, but major microfinance institutions in Uganda lack management control tools in directing the Microfinance institutions towards their strategic goal and are currently, independently financially sustainable.

Literature Review

Management Control System

Management control systems is designed to help an organization adapt to the environment in which it is set and to deliver the key results desired by stakeholder. Widener (2007), describes Management control as the process by which managers assure that resources are obtained and used effectively and efficiently in the accomplishment of the organization's objectives." (Anthony,1965). Management Control System is thus the process that links strategic planning and operational control (Merchant, K et al. (2007). Management Control Systems have the purpose of providing information useful in decision-making, planning and evaluation (Widener, 2007; Merchant & Otley, 2007). The focus of Management Control System is not only on one form of control like performance measures but on multiple control systems working together (Widener, 2007; Otley, 1980).

Simons (1995) argues that Management Control Systems are the formal, information-based routines and procedures managers use to maintain or alter patterns in organizational activities.

Merchant (2007), maintains that Management control systems thus have two main purposes: providing information useful to management and helping to ensure that resources are obtained and used effectively and efficiently in the accomplishment of the organization's objectives.The focus of Management Control System is not only on one form of control like performance measures but on multiple control systems working together (Widener, 2007; Otley, 1980).

Microfinance institutions, whether non-government organizations or banks, may not be using Management Control System jargon but they could already be using the Management Control Systems concepts or its building blocks. "Performance management" could be an alternative way of presenting Management Control System, as organizations are probably more familiar with this concept.

The fit between different organizational constructs is assumed to be associated with organizational performance. The matching of these constructs leads to better organizational performance. The appropriateness of different control systems depends on the business setting, (Chenhall 2003). Management control system in this study was conceptualized in terms of budgeting, Internal control system and performance measurement.

Budgeting

Pandey (2003) argues that a budget as a financial plan and as an action plan enables managers in achieving the objectives of the firm. Lucey (2003), maintains that budgeting provides a focus for the organization and aids the co-ordination and acts as a means of translating the overall objectives of the organization into detailed, feasible plans of action.

Welsh (2003) asserts that budgeting is the only comprehensive approach to managing so far developed that, if utilized with sophistication and good judgment fully recognizes the dominant role of the manager and provides a framework for implementing such fundamental aspects of scientific management as management by objectives, effective communication, participative management, dynamic control, continuous feedback, responsibility accounting management by exception and management flexibility.

Frederick (2001) argues that budgeting is the basis for directing and evaluating the performance of individuals or segments of organizations. Adams *et al* (2003) discussed that to be effective, budgets must, firstly, be aligned with; the organization's strategies, appropriate strategic planning and performance management processes introduced. And they must involve processes that are value based, consequential and continuous.

Internal control system

Bank failures and widespread losses over the past two decades have elevated the importance of effective risk management and internal control within the formal financial sector worldwide (Bald 2000).

According to Wterfield (1998), the microfinance industry also recognizes the importance of effective internal control. As microfinance institutions grow and more operate as regulated financial intermediaries, internal control becomes essential to long-term institutional viability. An effective system of internal control allows the MFI to assume additional risks in a calculated manner while minimizing financial surprises and protecting itself from significant financial loss. Thus, the primary objectives of the *internal control* process in a financial institution are: to verify the efficiency and effectiveness of the operations; to assure the reliability and completeness of financial and management information and to comply with applicable laws and regulations.

Microfinance institutions use internal control mechanisms to ensure that staff respects their organizational policies and procedures. However, internal control alone cannot ensure that the MFI is adequately minimizing its risk exposures. Only if the Microfinance institutions risk management strategies can be effectively integrated into its policies and procedures for internal control function to support risk minimization (Ledger wood 1999).

Internal Controls provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of the financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations (Mwindi, 2008). It is worth noting that internal controls only provide reasonable but not absolute assurance to an entity's management and board of directors that the organization's objectives will be achieved. Organizations establish systems of internal control to help them achieve performance and organizational goals, prevent loss of resources, enable production of reliable reports and ensure compliance with laws and regulations, (Morris 2011).

Bisbe (2004), also acknowledges that internal controls can only provide reasonable assurance that management objectives will be achieved. Internal control system is a process and not an end in or of itself. Internal controls provide reasonable but not absolute assurance about the attainment of an entity's objectives.

Performance Measurement

Financial institutions need activities that ensure that goals are consistently being met in an effective and efficient manner, (Aubrey 2004). Armstrong and Baron (1998), maintain that as a strategic and integrated approach to increasing the effectiveness of companies by improving the performance of the people who work in them and by developing the capabilities of teams and individual contributors.

According to Ledgerwood (1999), the performance of MFI is measured in many parameters.This includes: Portfolio Quality indicators: Portfolio quality ratios provide information on the percentage of non-earning assets, which in turn decrease the revenue and liquidity position of MFIs. Some of the measures used include the repayment rates, arrears rate, Portfolio at risk, delinquent borrowers, loan loss reserve ratio, and loan loss ratio.

Simon (1995) indicated that different management control systems will have different impacts on organization performance because different management control system often set by high level management is based on different strata or on how companies apply the interactive use of management control systems like financial budget.

Management Control Systems have the purpose of providing information useful in decision-making, planning and evaluation (Widener, 2007; Merchant & Otley, 2007). The focus of management control system is not only on one form of control like performance measures but on multiple control systems working together (Widener, 2007; Otley, 1980). Simons (1995) argues that Management control systems are the formal, information-based routines and procedures managers use to maintain or alter patterns in organizational activities

Null Hypothesis

The null hypothesis tested in this study was that: There is no significant difference in the level of management control system between the selected microfinance Institutions

The Methodology

The study employed the ex post facto or retrospective, prospective designs and descriptive survey design, and specifically descriptive comparative and descriptive correlation strategies, data was collected using a standardized questionnaire with questions relating to the demographic characteristics of respondent and Management control Sysytem of the selected Microfinance Institutions. The Cronbach's Alpha coefficient test indicated that the questionnaires where reliable since the coefficient was above 0.5 (α=0.859). Using the Sloven's formula, a minimum sample size of 266 was obtained from the sample population of 792. Data was collected using a combination of purposive and systematic sampling and simple random sampling, from a sample of 266 respondents from the selected Microfinance institutions in central region, Uganda and analysed using summary statistics, such as means and ranks. The null hypothesis was tested using the t-test, correlations and regression analysis

Findings

The level of Management Control system in the selected Microfinance institutions in central region, Uganda

The overall findings on management control system indicated that the microfinance institutions are efficient (overall mean=3.23) in the levels of management control system. This exhibited the existence of management control systems among the selected microfinance institutions in central region Uganda

Table 1: the level of management control system in regard to performance measurement, budgeting and internal control system

Item	Mean	Interpretation	Rank
Management Control Systems			
Performance measurement	3.25	Efficient	1
Budgeting	3.24	Efficient	2
Internal control System	3.21	Efficient	3
Total Average Mean	**3.23**	Efficient	

Source: Primary Data (2012)

Legend

Mean Range	**Response Mode**	**Interpretation**
3.26-4.00	Strongly Agree	Very Efficient
2.51-3.25	Agree	Efficient
1.76-2.50	Disagree	Inefficient
1.00-1.75	Strongly Disagree	Very Inefficient

an indication that most microfinance institutions are efficient in preparing budgets, receive budget targets, budgets are revievewed periodically, budgets are used to measure performance and microfinance institutions employees are allowed to participate in the budget process. When properly applied, budgeting improves an organization's ability to create and sustain superior performance (Tim 2006).

Microfinance institutions are efficient in performance measurement an indication that the microfinance institutions are efficient in the use of resources and comply with the respective laws. And also have efficient internal control system that is efficient in authorizations for acquisitions, in reviewing payroll calculations and have system on credit approvals meaning that underwriting is usually carried out before accredit facility is advanced

Table 2: Level of Management Control System between the Selected Microfinance Institutions in Central Region, Uganda

	Category	Mean	T	Sig.	Interpretation	Decision on Ho
Management control System	MFI A	3.1708	4.181	.000	Significant difference	Rejected
	MFI B	3.3079				

Source: Primary Data 2012

N.B. If the significant value is equal or less than 0.05 level of significance, the interpretation is **significant.**
If the significant value is more than 0.05 level of significance, the interpretation is **not significant**

The findings indicated that the views of the respondents in terms of management control System in Microfinance Institution A (mean =3.3079) is higher than in Microfinance Institution B (mean = 3.1708), suggesting a difference in the levels of Management Control system. The significance of this difference was supported by the t value (t = 4.181) which was small since its sig value (0.000) was less than $\alpha = 0.05$ resulting in to rejection of the null hypothesis and acceptance of the alternative hypothesis to the effect that there is a significant difference in levels of Management Control system between the selected microfinance institutions in Central Uganda at five percent level of significance (0.000< 0.05).

Conclusion

The overall findings on management control system indicated that the microfinance institutions are efficient in the levels of management control system. This exhibited the existence of management control systems in the selected microfinance institutions in central region Uganda

The levels of management control system differ significantly between the Selected Micro finance institutions in central region Uganda

Recommendations

1. Microfinance institutions should enhance, strengthen set and establish strong and effective control systems: all of the financial, operational and other control systems which are carried out by internal controllers and which involve budgeting, monitoring, independent evaluation and timely reporting to management levels systematically in order to ensure that all the institutions activities are performed by management levels in accordance with current policies, methods, instructions and limit.

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