



Contingency theory, performance management and organisational effectiveness in the third sector

A theoretical framework

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Received 15 September 2013

Revised 21 January 2014

1 March 2014

Accepted 10 March 2014

Abstract

Purpose – The purpose of this paper is to develop a theoretical framework that explains how performance management (PM) affects the organisational effectiveness in the third sector.

Design/methodology/approach – The authors adopt a two stage process in developing the theoretical framework; a systematic review of literature and theoretical developments of the framework. The underlying principles for developing the theoretical framework are mainly based on prior theoretical justification and empirical research in management accounting and international development fields.

Findings – Drawing upon contingency theory, the authors propose a theoretical framework explaining how the contingency variables affect PM and organisational effectiveness in the third sector. The authors discuss the justification for contingency theory as well as its weaknesses in the PM research. The authors also highlight how a modified Performance Management and Control Framework could be used to identify PM practices in the third sector. The organisational effectiveness can be measured using the four domains the authors suggest in this paper. Finally the authors put forward propositions that can be empirically tested in future studies.

Research limitations/implications – This conceptual paper opens an opportunity for future empirical research to cross-validate the model in a large survey through confirmatory factor analysis and structural equation modelling.

Practical implications – This paper helps researchers and practitioners to understand how modern PM tools integrate with third sector characteristics to optimise the effectiveness of individual organisations.

Originality/value – Integrating insights across disciplines, this paper strengthens cumulative knowledge on conceptualisation of PM and effectiveness within the third sector.

Keywords Performance measurement, Third sector, Performance management, Organizational effectiveness, Contingency theory, Performance management and control framework

Paper type Conceptual paper

1. Introduction

This paper develops a theoretical framework that explains how performance management (PM) affects organisational effectiveness in the third sector from a contingency theory perspective. In the last decade, PM and organisational effectiveness in the “third sector” [1] has gained the attention of the management accounting field as well as international development and public administration perspectives (Greiling, 2010; Greatbanks *et al.*, 2010; Moxham, 2010; Chenhall, 2007; Yap and Ferreira, 2011; Wadongo and Abdel-Kader, 2011). There have been calls for contingency research on PM to be extended to the third sector (Chenhall, 2007; Ferreira and Otley, 2009). Despite these calls, empirical studies investigating contingency variables influencing the use of PM systems in the third sector remain to be explored.



Unlike in the private and public sectors, where a variety of contextual variables influencing the use of PM systems have been empirically studied, only a few individual contingency factors, such as leadership, competition, resources, size and funding mandates, have been studied in the third sector. In particular, perceived environmental uncertainty (PEU), environmental dynamism, organisational structure, information technology (IT), strategic orientation and technology have largely been ignored. Furthermore, empirical studies that examine the linkage between PM and organisational effectiveness in the third sector remain scarce with conflicting findings (Taylor *et al.*, 2009; Lecy *et al.*, 2012; LeRoux and Wright, 2010) with some studies labelling the emphasis on performance measurement as unwanted destruction having dysfunctional negative effects on mission achievement due to the volume of resources required (Moxham, 2010). These limitations can be attributed to the lack of a sound and coherent generic theoretical framework underpinning the empirical studies. For instance, few studies use selected contingency variables without explicit reference to the contingency theory to explain variability of PM in the sector. Therefore this paper develops a theoretical framework that defines and explains relationships between the contingency factors, PM, and organisational effectiveness based on key arguments and empirical findings from the management accounting and non-profit management fields. The aim of the proposed theoretical framework is to guide future research in determining the key variables, type of statistical relationships linking the variables and theoretical assumptions from the contingency theory perspective. It can further form a basis for future research to test propositions. The remainder of the paper is structured as follows: Section 2 explains the theoretical underpinnings for the third sector and present theoretical foundations of PM and organisational effectiveness. Section 3 reviews the relevant literature. Section 4 discusses the theoretical framework development and formulation of proposition. Conclusions are in the final section.

2. PM in the third sector

2.1 Theoretical underpinnings

Organisations in the third sector share important underlying characteristics that differentiate them from private and public sector organisations, including profit maximisation objectives, revenue sources, goals, high transactions costs, multiple stakeholders and reliance on trust, social capital and voluntarism. Some of the key theoretical underpinnings for the third sector discussed in the literature include the public nature of the products and services, dependency on social capital, multiple stakeholders, asymmetric information, incomplete contracts and monitoring and incentive systems (Speckbacher, 2003; Taylor *et al.*, 2009; Beamon and Balcik, 2008; Kendall and Knapp, 2000; Chenhall *et al.*, 2010). Revenue sources are a key factor differentiating non-profit and for-profit organisations. For-profit organisations derive their revenue from the sale of products and services to customers, while NPOs get their revenue from monetary and non-monetary contributions from government, individuals and corporations. The implication is that in for-profit organisations, customers pay for goods for their own benefit while NPOs secure revenue from funders who do not expect any benefits in return (Henderson *et al.*, 2002).

In a conventional economy, the public sector ensures efficient resource allocation based on public preferences and those who demand differentiated goods are catered for by the private sector at a premium cost. However, the “public good” nature of NPOs’ products and services does not reflect the true market value or price, thus competition and price cannot be used as a measure of performance (Kendall and Knapp, 2000).

The interventions are produced at less-than-optimal level in the market as the NPOs' expenditures only reflect the social (production) costs but not the social (market) value. Thus, the public good properties of the NPOs' services make it challenging to measure their outputs, as the outcomes are widespread.

Social capital as an intangible resource has been central to the third sector for many years. It results from networks between people in the organisation rather than physical or human capital. People's formation of and involvement in the NPO represents socio-capital or generates it as a by-product (Kendall and Knapp, 2000). NPOs are well known for involving voluntarism in the implementation of their projects. The NPOs use volunteers to reduce project costs and to ensure participation by community members. In developing countries, most youths opt to volunteer for instrumental reasons due to high unemployment rates. While volunteering and membership is desirable in NPOs, it causes great challenges to the PM, as the volunteers are more than just "human resources" with incomplete contractual rights. They partly assume ownership rights to the organisation's ideas and success. Furthermore, they are not compensated at the market value; thus, the managers cannot demand a certain level of performance by enforcement of rewards and penalties. Traditionally, managers in the third sector have depended on informal processes based on shared trust, norms and values to develop and sustain social capital, rather than on coercive or formalised procedures. However, recent stakeholder accountability and effectiveness demands, coupled with rapid growth of the sector, have dictated the adoption of formal management controls and practices borrowed from the private sector that sometimes conflict with intrinsic values of the third sector (Chenhall *et al.*, 2010).

In organisations, owners of human and physical capital make specific investments to create value with expectations of acceptable share returns. The reliance for organisational success on specific investments and incomplete contractual relationships among multiple stakeholders poses challenges in managing these investments (Rajan and Zingales, 1998). Whereas the "traditional property rights view" assumes that residual right of control is with the owners, as other stakeholders are protected by complete contracts, the "modern perspective" assumes that stakeholders who make large and important specific unprotected investments should have primary decision rights. According to Speckbacher (2003), multiple stakeholders in NPOs make unprotected specific investments based on incomplete contracts with the expectation that NPOs will fulfil their implicit claim and thus return value on their investments. Based on the specific investments, the stakeholders can either be primary or secondary stakeholders. Primary stakeholders make the largest specific investment in the organisation and their investment is protected by giving them information and decision rights to interpret the mission and make decisions in the case of conflict. For-profit organisations have homogenous stakeholder groups, who make specific investments, explicit claims and interests and have residual and decision rights; thus they guide organisations' objectives and intentions. On the other hand, NPOs have heterogeneous multiple stakeholders with shared values but with conflicting interests and implicit claims. Although different stakeholders are motivated to work together sometimes, they hold different values and priorities, hence managing trade-offs between stakeholders is challenging to NPOs. PM is useful in balancing the stakeholder's investments and expected share, thus establishing the extent to which the implicit claims are met through stakeholder-oriented strategic performance measurement systems (Speckbacher, 2003; Neely *et al.*, 2001). Although technological and traditional property rights views of the firm, which provide the basis of performance measurement and owners' incentives for performance, are not

completely transferable to NPOs, Speckbacher (2003) argues that they address the question of how organisational goals can be translated into organisational actions through monitoring and incentives systems that are applicable to NPOs. Monitoring systems are applicable to non-profit measurement so long as there is clarity of goals and measures. However, other characteristics of the third sector stated earlier, such as the lack of primary owners, asymmetric information, the absence of market prices, the subjective nature of inputs and outcomes and reliance on limiting financial reporting systems, make monitoring processes complicated and costly (Kendall and Knapp, 2000).

The above theoretical underpinnings for the third sector pose both challenges and opportunities for applicability of private sector PM principles to the third sector. For instance, the inherent and unique characteristics of the third sector pose significant challenges to selecting appropriate performance metrics and developing measurement systems (Beamon and Balcik, 2008). Thus, distinctive characteristics of for-profits and NPOs result in unique PM needs as well. In this paper we develop a theoretical framework that explains how modern PM tools are integrated with the third sector characteristics and context to optimise its effectiveness.

2.2 PM

Performance can be defined as the past, present or future accomplishment of a given organisational task or dimension measured against pre-set known standards of accuracy, completeness, value, or time. Effective PM requires a coordination of key activities and related practices undertaken within a system supported by a measurement framework (De Waal, 2003; Rouse and Putterill, 2003). Wadongo and Abdel-Kader's (2011) review of the literature identified 20 performance measurement frameworks developed for the third sector in the last ten years. Despite these developments, previous studies have drawn the attention to a gap between the theoretical development of PM and actual practices in organisations. For instance, Pollit (2005) laments the shortage of comparative empirical research into the "actual practices" of PM beyond the "surface rhetoric of performance measurement". We suggest the adoption of Ferreira and Otley's (2009) "Performance Management and Control Framework" (PMCF) to explore current PM practices. Drawing from Simons' (1995) concept of "levers of control" Ferreira and Otley extended the Otley (1999) framework to a more comprehensive PMCF that provides a broad basis of studying PM not only in the private sector but also in the third sector. Ferreira and Otley expanded the initial Otley (1999) five issues (questions) to 12 – eight of which relate to functional concerns (determinants and results) of PM system design with a further four capturing the underlying contextual and cultural factors – explicitly referred to in Ferreira and Otley (2005) but removed in the final Ferreira and Otley (2009) model. The 12 questions relate to: vision and mission, organisational objectives and purposes; key success factors; organisational structure; strategies and plans; key performance measures; performance targets setting; performance measurement and evaluation; rewards for performance; information flows and feedback systems; performance information use; MS dynamism; strength and coherence.

We believe that the generic nature of PMCF makes it appropriate for exploring PM in the third sector. It has been argued that this generic framework is not only useful in exploring PM systems but also can facilitate data collection from multiple organisations (Broadbent and Laughlin, 2009; Yap and Ferreira, 2011). PMCF is unique because it puts forward core issues that can be considered in design, implementation, analysis and evaluation of control systems. It is flexible to be used in various organisations or hierarchy levels, which is useful in NPOs due to multiple projects.

Although PMCF recognises aspects of context and culture issues, it distances itself from contingency theory and other environmental factors while including organisational structure in the framework. The framework fails to capture the organisational context complexity and fully account for how the context influences the functional characteristics of the PM system or how they can reshape them (Broadbent and Laughlin, 2009). Furthermore, the use of the framework in third sector research remains limited; however, Yap and Ferreira (2011) demonstrate its usefulness through a case study.

In this paper we propose that the 12 PM practices described in the PMCF should be broadly summarised into three phases as follows: performance planning, performance measurement and PM system context. Performance planning includes practices of how the organisation goes about defining and communicating mission, vision, objectives, goals, key success factors, strategies and plans. Performance measurement involves identification and definition of key performance domains and indicators, performance targets, data collection methods and rewards and incentives. Finally, PM system context comprises practices related to contextual factors such as information flow systems, performance information use, PM system dynamism and PM system strength and coherence. The particular depth and specificity of the system will depend on the individual organisation context. The utilisation of this framework will not only advance the previous research, but also demonstrate the applicability of the framework to the third sector. We believe that by using this framework in the third sector context, future studies can generate valuable insights into PM in these organisations

2.3 Organisational effectiveness

Organisational effectiveness as a measure of organisational success has attracted scholarly attention for decades (Mausolff and Spence, 2008; Leczy *et al.*, 2012). However, there is little agreement on how to define and measure what constitutes organisational effectiveness. Several authors have operationalised the effectiveness construct (Sowa *et al.*, 2004; Leczy *et al.*, 2012). For example, Beamon and Balcik (2008) define effectiveness as the extent to which clients' needs are being met while defining efficiency as being how effectiveness is achieved in relation to resources used. Organisational effectiveness is the extent to which a NPO accomplishes its mission and meets its objectives and goals (Benjamin and Misra, 2006). This paper focuses on organisational effectiveness as it represents the achievement of the NPOs' intentions, missions, visions and objectives. Theories on effectiveness measurement have been summarised into four measurement approaches, namely goal attainment, systems resource approach, reputational approach and multidimensional approach (Leczy *et al.*, 2012). Goal attainment approach, emphasised that organisational effectiveness could only be measured by progress towards achieving goals. However, this approach has been criticised since NPOs lack single and specific goals. To address this limitation, systems resource approach was proposed, emphasising organisational survival. Under this approach, organisation effectiveness is viewed as the ability for NPOs to utilise their environment to gain scarce and valuable resources to achieve goals (Ritchie and Kolodinsky, 2003). The approach has been critiqued for its focus on financial variables such as expenditure and revenue to measure effectiveness, hence the emergence of the reputational approach. The reputational approach relies on the subjective measures of perception of multiple key stakeholders to measure organisational effectiveness (Herman and Renz, 2004). It is based on the belief that organisational legitimacy will enable a non-profit to operate in a particular complex sector with multiple stakeholders. The approach has been criticised due to stakeholders' lack of consensus on effectiveness, particularly in the

third sector where there are no primary stakeholders with decision rights. To address the weaknesses of previous approaches, multidimensional models of effectiveness were put forward, incorporating aspects of goal attainment, system resources and reputational dimensions of effectiveness at different organisational levels (Kendall and Knapp, 2000; Kaplan, 2001; Sowa *et al.*, 2004). In this paper we adopt Lecy *et al.* (2012) model which summarises four multidimensional domains of NPOs effectiveness as organisational management, programme design and implementation, responsiveness to environment and partnerships and networks incorporating goal attainment, resource systems and reputational measurement approaches. The organisational management domain focuses on activities, processes and outcomes of NPOs' own governance and core management systems. The programme design and implementation domain focuses effectiveness of specific projects and programmes related to the goal attainment approach. The responsiveness to the environment domain relates to NPOs' capacity and outcomes in relation to resource mobilisation, resistance to political and other negative external influences, to ensure future survival and sustainability. Partnerships and networks incorporate capacity and outcomes of collaborations with other stakeholders in either horizontal or vertical forms across economic sectors. These four domains capture the complex relationships among the indicators of effectiveness. Despite the potential benefits of multidimensional models, research has shown that they are difficult to implement in practice, particularly in NPOs, due to their complexity, information overload and lack of resources and experience in such systems (LeRoux and Wright, 2010; Moxham, 2009; Carman, 2007). Multiple and independent conceptualisations of effectiveness pose a number of challenges for researchers measuring effectiveness. We adopt the view that organisational effectiveness is a set of interdependent relationships between its four domains and not a summation of all components.

2.4 Contingency theory of PM

Contingency theory of PM is based on the argument that there is no universally appropriate PM system that applies equally to all organisations in all conditions but particular features of the system and its effectiveness will depend on specific organisational and contextual factors (Otley, 1980; Rejc, 2004; Ferreira and Otley, 2005). Ferreira and Otley (2005, p. 41) clearly point out that it has been "[...] shown that variables relating to external environment, strategy, culture, organisational structure, size, technology and ownership structure have an impact on the control system". Speckbacher and Offenberger (2010) concludes that "non-profit-specific" attributes or "the non-profit character of an organisation" influences the appropriate design of its management control system. Lecy *et al.* (2012) observe that organisational effectiveness of NPOs depends upon the environment and organisational context. In this paper we rely on Chenhall (2007) and Rejc's (2004) discussion on contingency research to identify and discuss the relationships between key contingency variables and PM which forms the basis for the proposed theoretical framework. Even though over the years correlations between contingency variables and management control systems have been empirically confirmed, several problems have been highlighted with regard to the use of contingency theory in research. Some weaknesses of the previous research include study of a single or two variables through selection fit and reliance on interaction effects, which is problematic due to the shared commonality between the contingency variables.

The other criticism is that causation is assumed between contingency variables and PM systems, but the relationships are not explained in depth to rule out other factors

(Betts, 2011). According to Chenhall (2007), lack of replication of studies to other context like the third sector and lack of focus on current aspects of PM system seems to be limiting the ability to update and generalise contingency theory across disciplines. For instance, it was clear from Wadongo and Abdel-Kader's (2011) review that the influence of strategic orientation, technology, and PEU on PM has not been examined in the third sector. Ferreira and Otley (2010) point out that studies utilising contingency theory suffer from methodological and theoretical weaknesses such as too few variables, model under specification, and measurement error leading to conflicting findings. Despite the limitations of the contingency theory, it remains a plausible theory to understand the relationship between contextual variables and PM in the highly complex and dynamic third sector context. To address the above concerns, we propose a framework using the following contingency variables; organisational size, technology, structure, strategy, leadership, culture, environmental competitiveness, environmental dynamism, and environmental predictability in a system approach.

3. Literature review

3.1 Contingency variables and PM

Prior research identifies contingency variables (organisational and external environment) influencing the adoption of PM systems and the choice of performance measurement tools and practices in public, private and third sectors. The various organisational factors that influence the adoption of PM systems in organisations include size, organisational structure, strategy, technology, culture and leadership. External environment is a significant contingent factor that includes a degree of environmental unpredictability or uncertainty, the degree of competition or hostility exhibited and the environmental dynamism or turbulence faced by the organisation. This section reviews these variables in relation to the third sector context.

A review of literature reveals a positive relationship between organisational size and PM (Zimmerman and Stevens, 2006; Thomson, 2010; LeRoux and Wright, 2010; Carman, 2007). NPOs with small budgets and low numbers of staff exhibit significantly lower performance than those with large budgets and more staff. Unlike in the private sector, where measures of organisational size levels are standardised (Gupta, 1980), measures of organisational size (number of staff or size of the budget) in the third sector seem to be arbitrary, hence the need for further empirical research. Organisational structure is another contingency which has been positively linked to the adoption of PM systems (Ferreira and Otley, 2010; Chenhall, 2007). In addition, organisational structure has been closely linked to organisational strategy (Brown and Iverson, 2004), performance measurement (Poole *et al.*, 2001) and organisational success (Kushner and Poole, 1996) in the third sector. Although organisational structure has been linked to organisational effectiveness (Kushner and Poole, 1996) as well as organisational decline (Galaskiewicz and Bielefeld, 1998), there seems to be a lack of evidence on the impact of fit between organisational structures, strategy and PM on the organisational effectiveness in a systems approach.

Strategic orientation is argued to play a key role in adoption and implementation of PM systems (McAdam and Bailie, 2002; Maltz *et al.*, 2003) and organisational effectiveness (Siciliano, 1996; Brown and Iverson, 2004) in organisations. Furthermore, recent studies in for-profit organisations (Spencer *et al.*, 2009; Teeratsirikool *et al.*, 2013) reveal that strategic orientation has an indirect effect on performance through performance measurement. Strategic intentions of the NPOs influence the relative importance of and managements' preference for certain performance measures

(Waweru and Spraakman, 2009). Strategic orientation interacts with external environment and other organisational variables, to influence performance measurement and organisational effectiveness (Edwards, 1999; Waweru and Spraakman, 2009; Akingbola, 2006; Brown and Iverson, 2004). Although some studies have extended Miles and Snow's strategic typologies to the third sector linking it with operating environment (Akingbola, 2006) and organisational performance (Brown and Iverson, 2004), a review of literature reveals that linkage to the PM in the third sector remains unexplored. Thus, there is a need to explore the relationship between external environment, strategic orientation, PM and organisational effectiveness in the third sector.

Organisational leadership is defined as the roles and processes that "facilitate setting direction, creating alignment and maintaining commitment in groups of people who share common work" to achieve direction, alignment and commitment (Van Velsor *et al.*, 2010, p. 2). Leadership characteristics include managers' education and functional training, effective governance and leader professionalism and managerial styles and beliefs. Previous studies have found a relationship between organisational leadership, PM and organisational effectiveness (LeRoux and Wright, 2010; Moynihan and Ingraham, 2004; Teelken, 2008; Wadongo *et al.*, 2010). Effective leadership is essential for addressing PM challenges resulting from changes in the external environment in the third sector (Alexander *et al.*, 2010). For instance, a study by Moynihan and Ingraham (2004) indicated that leadership and professionalism had an impact on the extent of performance information use. Thus, there is a need to investigate the relationship between leadership, external environment, PM and organisational effectiveness.

Organisational culture refers to beliefs, norms and values that influence the behaviour of people who work in NPOs (Poole *et al.*, 2001). Although previous research has focused on the influence of national cultures on management control systems (Berry *et al.*, 2009), it is argued that a dominant internal culture and its interaction with leadership may dominate national culture in the work situation, and thus influence actual PM system implementation (Chenhall, 2007; Poole *et al.*, 2001). Organisational culture influences performance measurement, leadership and organisational effectiveness (Teelken, 2008; Julnes and Holzer, 2001; Thomson, 2010; Duke and Edet, 2012). Chenhall (2007) concludes that organisational culture may be of more importance to adoption of PM systems in NPOs, hence the need for more evidence.

Technology refers to the way the organisation's work processes function to convert inputs into outputs, which include materials, machines, tools, people's tasks, software and knowledge. From the contingency perspective, the generic types of technology that influence the adoption and utilisation of PM systems include technological complexity, task uncertainty and technological interdependence (Chenhall, 2007). In the non-profit literature, technology is defined as the requisite knowledge, skills, information tools, systems and resources necessary to implement performance measurement (Poole *et al.*, 2001; LeRoux and Wright, 2010; Thomson, 2010). This interaction is further associated with organisational structure and external environment (Poole *et al.*, 2001; Hage and Aiken, 1969). Chenhall's (2007) review reveals that previous studies on technology have largely been completed in the manufacturing sector, with recent extension to service and government sectors. Thus, there is a need to examine the relationship between technology, IT, structure, external environment and PM and organisational effectiveness.

IT includes operations automation level, IT application level, modern communication technologies and use of specialised software, which is positively related to planning and

outcome measurement. There is a relationship between technology, size, IT, strategy, PM and organisational effectiveness (Chenhall, 2007; Khandwalla, 1977; Poole *et al.*, 2001; Pasupathy and Medina-Borja, 2008). Information and communication technology as an aspect of technology has also been discussed as key to the implementation of the PM system by assisting or hindering data collection and subsequently performance measurement. However, the level of adoption is dependent on organisational size, resources allocated and strategic alignment (Finn *et al.*, 2006). Although IT clearly plays an important role in management control (Berry *et al.*, 2009), its relationship with PM has not been studied extensively in the third sector.

Environmental competitiveness is mainly associated with private sector organisations. However, NPOs need to respond to the increasing market pressures and competitiveness in the sector. Hubbard (1997) stated, "Whilst non-profits do not have a commercial orientation, they are in fact in a competitive situation" (p. 79). Environmental competitiveness in the third sector is characterised by intense competition for staff and volunteers, external funding, new innovative projects and community resources. The type of competitive environment determines the need for interactive information and communication of strategic threats and uncertainties (Waweru and Spraakman, 2009). A hostile or competitive environment is positively associated with formal controls and budgets (Kaplan, 2001; Ferreira and Otley, 2010; Chenhall, 2007). Literature from management accounting indicates that changes in the competitive environment are associated with strategy, organisational design and technology, all of which are associated with the use of non-financial indicators in organisations (Baines and Langfield-Smith, 2003). Competition for funding has been associated with performance measurement practices in NPOs (LeRoux and Wright, 2010; Speckbacher, 2003; Zimmerman and Stevens, 2006). Thus, there is a need to examine correlations between environmental competitiveness, PM and effectiveness in the third sector.

Environmental dynamism, which includes tense economic and political climates, regulatory concerns and a rapidly changing technological environment, often poses challenges to the third sector, thus affecting performance. As environmental dynamism is highly uncertain, an organisation faces frequent changes in the regulatory, socioeconomic, political and technological environment. Environmental dynamism has been associated with strategic orientation, organisational structure, adoption of PM systems and organisational effectiveness, with conflicting findings (Waweru and Spraakman, 2009; Galli, 2011). A turbulent or dynamic environment is positively associated with formal controls and budgets (Kaplan, 2001; Ferreira and Otley, 2010; Chenhall, 2007). Although environmental dynamism has been associated with PM systems in general organisational theory literature and accounting research, this relationship remains to be explored in the NPOs context.

Environmental uncertainty or unpredictability is associated with design and implementation of comprehensive PM systems (Kaplan, 2001; Ferreira and Otley, 2010). It is further associated with the adoption of broad, flexible, externally focused management control systems emphasising non-financial measures (Kaplan, 2001). Diverse stakeholder requirements and accountability demands pose particular challenges to measuring performance due to their uncertainty (Poister, 2003; Moxham, 2010). External requirements and accountability demands refer to directives generated and imposed by external stakeholders; commonly regulators, public, government donors, volunteers, beneficiaries and boards of directors (Lee, 2004; Carman, 2007). The stakeholders demand that NPOs measure performance for a range of purposes, including organisational learning, monitoring and evaluation. According to Lee (2004),

NPOs have a compulsory external financial reporting accountability to government agencies and state regulators. Funders reporting mandates have received much attention in the literature compared to other stakeholder groups, as they require detailed documentation of performance information from NPOs. However, Christensen and Ebrahim (2006) argue that upward accountability requirements of donors do not necessarily yield an improved mission achievement. Although a considerable proportion of management accounting research in the private sector supports the notion that environmental uncertainty is positively associated with PM systems (Chenhall, 2007), research in the third sector remains limited (LeRoux and Wright, 2010). In particular, the relationship between unpredictability of stakeholder requirements and accountability and performance measurement in the third sector needs to be examined.

A review of the literature reveals that size, culture and leadership have been relatively well covered in theoretical and empirical studies, while technology, IT, structure, strategic orientation and external environment have not been widely studied as contingencies of PM in the third sector. Therefore, we address this gap by putting forward propositions that explain the relationships between contingency variables and PM.

3.2 PM and organisational effectiveness

Several authors argue that performance planning leads to an improved organisational effectiveness in either for-profit or NPOs (Blackmon, 2008; Franklin, 2011). However, few studies in the general management field report conflicting findings, with some studies reporting a positive relationship (Bart and Tabone, 1998) and others reporting no significant relationships (Klemm *et al.*, 1991; Coats *et al.*, 1991). For instance, Bart and Tabone (1998, p. 54) concluded that “the fact that there is no reliable and recognised base of research on mission statements is somewhat amazing because the virtues of having a well-articulated mission statement are extolled in almost every current management textbook”. Although PM systems have been adapted to reflect performance planning aspects, there seem to be few rigorous academic studies that have empirically confirmed the relationship between performance planning and organisational effectiveness in the third sector (Ghoneim and El Baradei, 2013; Desmidt and Prinzie, 2009).

The relationship between performance measurement and organisational effectiveness in NPOs is well covered in the literature. Previous studies have found a positive relationship between performance measurement and financial performance (Siciliano, 1997), programme effectiveness (Mausolff and Spence, 2008; Zimmerman and Stevens, 2006), achievement of goals (Henderson *et al.*, 2002), and decision-making effectiveness (LeRoux and Wright, 2010). On the other hand, the literature suggests the existence of negative effects of performance measurement such as increased bureaucracy in NPOs, and resource drain, detracting from activities that support service delivery efficiency and effectiveness, and limiting performance improvement (Moxham and Boaden, 2007; Moxham, 2009, 2010; Benjamin and Misra, 2006). Although LeRoux and Wright (2010) report a positive relationship between performance measurements and perceived strategic decision-making, not all non-profit managers are convinced of the benefits of performance measurement. In agreement, Mueller *et al.* (2006) argue that additional time and resources expended on performance measurement will distract managers, staff and volunteers from delivering their key intentions. The conflicting findings necessitate more empirical evidence. The effect of performance measurement frameworks and performance indicators on organisational effectiveness is well covered. However, the effect of other components such as performance targets,

data collection methods and performance rewards on NPOs effectiveness remains to be examined.

PM system context are practices related to a set of underlying contextual issues, which permeate the PM system such as information flow, information use, dynamism and coherence. The information flow in organisations needs to be examined in detail in order to create a connection between performance data, subsequent management actions and organisational effectiveness (Franco-Santos *et al.*, 2007). Performance information use influences organisational decision-making, changes in programme priorities and strategic focus as well aligning organisational resources to the objectives (Poister and Streib, 1999; Kaplan, 2001). Mausolff and Spence (2008) found a relationship between use of information for organisational learning and programme effectiveness. However, Alexander *et al.* (2010) argue that performance information use in NPOs remains unclear despite the recent empirical evidence. PM system dynamism is advocated in order to improve organisational effectiveness. A recent case study by Korhonen *et al.* (2013) concludes that PM dynamism leads to the use of updated measures, which could lead to a more efficient strategy implementation. The review of literature reveals that PM dynamism and organisational effectiveness is not widely addressed in the management accounting literature (Henri, 2010; Malina and Selto, 2004) and even less in the third sector. The strength and coherence of the links within PM systems components and other organisational processes is crucial to successful implementation and alignment. The combination and interaction of components will have an effect on organisational outcomes (Ferreira and Otley, 2009). Generally, an examination of the literature reveals a lack of studies examining the relationship between the PM system context and organisational effectiveness in NPOs. To conclude this section, the relationship between performance measurement and organisational effectiveness is well established. However, the relationship between performance planning and PM system context and organisational effectiveness remains to be investigated. To address this gap we put forward propositions that explain the relationship between PM and organisational effectiveness in the third sector.

3.3 Mediation effects of PM

From the extant literature discussed above it appears that PM mediates the relationships between contingency variables and organisational effectiveness (Gerdin, 2005; Mausolff and Spence, 2008; Teeratansirikool *et al.*, 2013). For instance, using the structural equation modelling approach, Mausolff and Spence (2008) examine the direct and indirect linkage between competence, performance measurement, results, organisational learning and programme effectiveness. Citing psychological studies, they argue that performance feedback leads to individual and organisational learning. Ferreira and Otley (2009) and Kendall and Knapp (2000) conclude that contingency variables (external and internal) affect design and implementation of PM systems within organisations. On the other hand, Edwards (1999, p. 364) cautions that “NGO performance (effectiveness) is the outcome of a dynamic interaction between external influences (context) and internal influences (organizational choices)”. The above arguments point to the conclusion that the PM in NPOs needs to be examined from a systems approach emphasising effect of fit between contingency variables and the PM systems on multiple effectiveness domains. However, there seem to be few empirical studies testing the mediation effects of PM in the third sector. Thus we put forward propositions explaining the mediation effects of PM.

4. Theoretical framework development

A variety of theoretical fits have been used to categorise contingency-based research in PM field: selection approach, congruence (matching fit or misfit), interaction fit, systems approach, intervening variable approach and structural modelling. The selection approach examines the pairs of contingency variables and PM systems (Luft and Shields, 2003). The congruence approaches examine how different combinations of levels of the contingency variables and PM systems lead to a higher organisational effectiveness than other combinations (Ferreira and Otley, 2010). The interaction fit approach examines the influence of particular aspects of context on the nature or strength of a relationship between PM and organisational effectiveness (Chenhall, 2007). An overview of the literature reveals that most studies in the PM field seem to rely on the selection approach and the interaction fit of selected contextual variables (Chapman, 1997). Earlier Drazin and Van de Ven (1985, p. 358) argued that, “[...] a major limitation of many studies has been an overly narrow focus on only one or a few contextual dimensions, which limit the studies from exploring the effects of multiple and conflicting contingencies on organisation design and performance”. This selection fit of one factor at a time, is believed to be problematic due to a shared commonality between the contingency variables (Ferreira and Otley, 2010; Fisher, 1995; Otley, 1980). In particular, studies in the third sector suffer from this selection fit problem. The systems approach examines how contingency variables and multiple aspects of PM systems interact in a variety of ways to enhance organisational effectiveness (Selto *et al.*, 1995; Sowa *et al.*, 2004). The intervening variable approach examines the relationship between PM systems and organisational effectiveness through an intervening contextual variable (Bisbe and Otley, 2004; Shields *et al.*, 2000). Fisher (1995, p. 24) proposed that “the ultimate goal of contingency control research should be to develop and test a comprehensive model that includes multiple control systems, multiple contingent variables, and multiple outcome variables”.

Despite the existence of several theoretical modelling approaches, there is a consensus that the specification of structural relations and the nature of the causality between the variables should be based on substantive theoretical justifications (Chenhall, 2007; Luft and Shields, 2003). It is worth noting that examining the linkage between PM variables and organisational effectiveness has been criticised in earlier studies due to the small effect it is likely to have on organisational effectiveness and claims of causality in regards to the use of PM techniques and organisational effectiveness (Ferreira and Otley, 2010). Past performance can also influence the adoption and use of PM systems leading to non-recursive models. However, the extant literature we reviewed validates the premise that the desire and intentions of design and implementation of PM systems in the third sector is to respond to contextual challenges in order to improve organisational effectiveness, thus providing the theoretical underpinning of empirically testing such an assumption.

The above arguments point to the conclusion that PM in NPOs needs to be examined from a system approach perspective; emphasising the effect of fit between contingency variables and the PM systems on multiple effectiveness domains. The literature review points to the potential use of PM as a mediating variable of the relationship between contingency variables and organisational effectiveness in a system fit approach (Gerdin, 2005; Henri, 2004; Mausolff and Spence, 2008; Smith and Langfield-Smith, 2004; Baines and Langfield-Smith, 2003). Antecedent mediating variable models may help assess whether the relationship between contingency variables and organisational effectiveness is direct or whether it operated indirectly

through the PM. Consequently, the importance of developing and testing theories of mediating effects of PM systems in management accounting research through structural equation modelling are not only important to theory development, but also in bridging the gap with other management fields such as non-profit literature. Lecy *et al.* (2012) and Sowa *et al.* (2004) recommend simultaneous modelling (through SEM) of any organisational process with effectiveness in order to understand the effect of the process and other factors on effectiveness, as particular domains can be either a dependant or independent factor in the same context. Verbeeten (2008) recommends that the research on effects of PM should separate effects of PM components on various effectiveness domains, as the effect may not be similar.

In this study, we use a system approach to develop a theoretical model of contingency variables, PM and organisational effectiveness in the third sector. Our intention is not to infer causality rather to propose a theoretical model that explains how the fit between contingency factors and PM predicts organisational effectiveness in the third sector. The theoretical framework is based on PMCF (Ferreira and Otley, 2009); contingency theory of PM (Rejc, 2004) and the organisational effectiveness domains model (Lecy *et al.*, 2012). The theoretical framework is presented as a structural model, see Figure 1. The organisational and external environmental determinants are the exogenous independent contingency variables. PM is the endogenous mediating variable. Organisational effectiveness is the dependent endogenous variable.

4.1 Propositions

Drawing upon management accounting contingency theory research, we theorise how contingency variables, PM and organisational effectiveness are linked to each other. We summarise relevant propositions between existing concepts in three categories. The first category includes the propositions that are related to the contingent variables that affect PM. The second category describes the propositions that are related to the influence of PM on organisational effectiveness. The third category includes propositions related to mediation effects of PM on the relationship between contingency variables and organisational effectiveness.

4.1.1 Contingency variables and PM. The various organisational factors that influence the adoption of PM systems in organisations include size, organisational structure, strategy, technology, culture, and leadership. External environment is a significant contextual factor, which includes its degree of predictability or uncertainty, the degree of competition or hostility exhibited, and environmental dynamism or turbulence faced by the organisation.

4.1.1.1 Organisational determinants. Several studies (Zimmerman and Stevens, 2006; Moxham, 2009; Thomson, 2010) suggest a positive relationship between size and PM in the third sector. Organisational size has been measured using the number of clients serviced, the number of staff, and the size of operating budget. Contingency theory suggests that variety of structural patterns observed in organisations coupled with strategy and PM systems to influence organisational effectiveness (Poole *et al.*, 2001; Kushner and Poole, 1996; Brown and Iverson, 2004; Galaskiewicz and Bielefeld, 1998). Organisational structure has been measured using the degree of ownership closeness, specialisation, formalisations, decentralisation, complexity and stratification (Brkic *et al.*, 2011). Strategic orientation plays an important role in the adoption and implementation of comprehensive PM systems (Waweru and Spraakman, 2009) and organisational effectiveness (Akingbola, 2006). Management accounting researchers have measured organisation strategy through Miles and Snow's strategic typologies

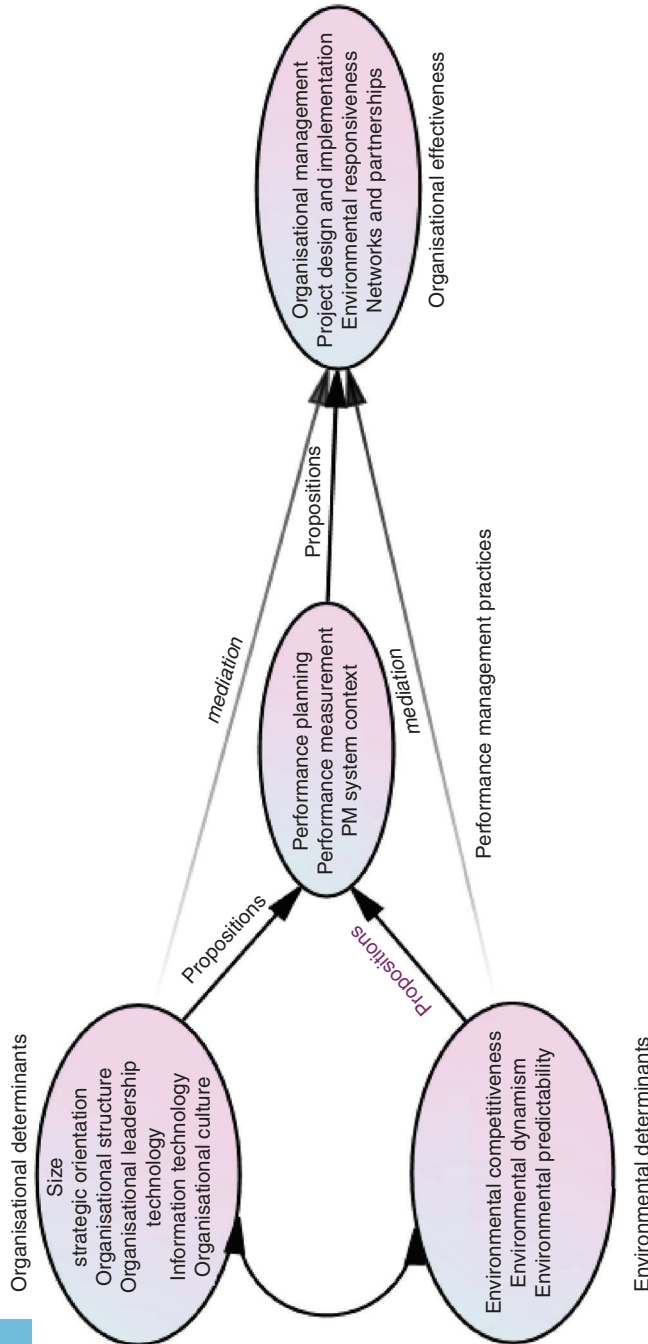


Figure 1. Theoretical framework

(defenders, reactors, analyser and prospectors) and Porters' cost leadership and differentiation. However, studies have demonstrated that typological divisions are not that useful (Akingbola, 2006; Brown and Iverson, 2004). A number of strategic types are utilised in a single organisation to achieve optimal effectiveness and respond to the external environment, although one strategy emerges as dominant. Organisational leadership dimensions include the level of professionalism, functional background, education level, and the board governance effectiveness and top management micro-involvement in organisational processes, all of which have been associated with PM and organisational effectiveness (LeRoux and Wright, 2010; Moynihan and Ingraham, 2004; Carman, 2007; Alexander *et al.*, 2010). From the several studies, it can be concluded that organisational culture interacts with leadership, and technology to influence performance measurement and organisational effectiveness (Teelken, 2008; Duke and Edet, 2012; Poole *et al.*, 2001). Culture is measured by pro-activeness, informal relations and cooperation. Other parameters are collectiveness and power decentralisation. From the contingency perspective, the generic types of technology that influence adoption and utilisation of PM systems include technological complexity, task uncertainty and technological interdependence (Chenhall, 2007; Hage and Aiken, 1969; Poole *et al.*, 2001; LeRoux and Wright, 2010; Thomson, 2010). Technology has been expanded to include operations automation level, IT application level, modern communication technologies and use of specialised software, which have been positively related to planning, and performance measurement (Chenhall, 2007; Khandwalla, 1977). Thus, we propose the following propositions:

- There is a positive relationship between organisational size and PM in the third sector.
- There is a positive relationship between an organic organisational structure and broad PM systems in the third sector.
- There is a positive relationship between strategic orientation and use of broad PM systems in the third sector.
- There is a positive relationship between level of micro involvement of organisational leadership and use of broad PM practices in the third sector.
- There is a positive relationship between soft people organisational culture and use of broad PM systems in the third sector.
- There is a positive relationship between technology and PM in the third sector.
- There is a positive relationship between use of IT and use of broad PM systems in the third sector.

4.1.1.2 Environmental determinants. Environmental competitiveness is a significant contextual factor in the contingency research (Ferreira and Otley, 2010; Chenhall, 2007). Environmental competitiveness can be measured by level of competition for staff and volunteers, competition for external funding, number of new innovative products and services and competition for community resources among NPOs. In the third sector, competition for funding is associated with performance measurement (LeRoux and Wright, 2010; Zimmerman and Stevens, 2006). Environmental dynamism represented by changes in technology, socioeconomic, regulatory and political change is associated with adoption of PM systems and organisational effectiveness (Kaplan, 2001; Ferreira and Otley, 2010; Chenhall, 2007; Waweru and Spraakman,

2009; Galli, 2011). Management accounting research suggests that high levels of PEU are associated with design and implementation of comprehensive, broad, flexible, externally focused PM systems emphasising nonfinancial measures (Kaplan, 2001; Ferreira and Otley, 2010). Environmental predictability was conceptualised as the ability to predict stakeholder's requirements and accountability demands mainly regulators, and board of directors, public, government donors, volunteers and beneficiaries (Poister, 2003; Moxham, 2010; Thomson, 2010; Zimmerman and Stevens, 2006). Thus, we propose that the following propositions:

- There is a relationship between environmental competitiveness and the use of broad PM systems in the third sector.
- There is a positive relationship between environmental dynamism and the use of broad PM systems in the third sector.
- There is a positive relationship between environmental unpredictability and the use of comprehensive PM systems in the third sector.

4.1.2 PM and organisational effectiveness. Several studies have investigated, the relationship between PM and organisational effectiveness with some studies reporting a positive effect (LeRoux and Wright, 2010; Alexander *et al.*, 2010) while others other studies have concluded that PM in NPOs detracts organisational performance and continuous improvement (Moxham, 2009; Benjamin and Misra, 2006). Previous studies have found positive relationships between these aspects and organisational effectiveness and performance not only in for-profit but also in NPOs (Siciliano, 1996; Griggs, 2003; Blackmon, 2008; Franklin, 2011; Ghoneim and El Baradei, 2013). Some studies have reported a positive relationship (Desmidt and Prinzie, 2009) while others concluded that there were no significant relationships (Griggs, 2003). The relationship between performance measurement and organisational effectiveness in the third sector is well covered (Kaplan, 2001; Siciliano, 1997; Mausolf and Spence, 2008; LeRoux and Wright, 2010; Zimmerman and Stevens, 2006; Poister and Streib, 1999; Berman and Wang, 2000). Although previous studies have not explicitly linked PM system context to organisational effectiveness in NPOs, the general management accounting literature suggests a positive relationship (Ferreira and Otley, 2005, 2010; Franco-Santos *et al.*, 2007; Poister and Streib, 1999; LeRoux and Wright, 2010; Korhonen *et al.*, 2013). Thus we propose that the following propositions:

- There is a positive relationship between performance planning and organisational effectiveness domains.
- There is a positive relationship between performance measurement and organisational effectiveness domains.
- There is a positive relationship between PM system context and organisational effectiveness domains.

4.1.3 Mediation effects of PM. Researchers within the management accounting field point out that the adoption and implementation of PM systems and control systems in organisations is dependent on contingency variables (Rejc, 2004; Ferreira and Otley, 2005; Chenhall, 2007). Subsequently effective PM systems lead to better organisational effectiveness (Henri, 2006; LeRoux and Wright, 2010; Alexander *et al.*, 2010). On the other hand, researchers within organisational theory and the non-profit field argue that organisational effectiveness is influenced by factors such as employee performance,

motivation, leadership, strategy, technology, culture and external environment factors (Donaldson, 2001; Brown and Iverson, 2004; Lecy *et al.*, 2012; Malik *et al.*, 2011; Edwards, 1999). Thus, contingency theory aims to prescribe to practitioners the level of fit between contextual variables and PM systems that will result in optimal organisational effectiveness. Hence, PM systems are implemented in organisations to improve effectiveness by enabling the managers to better cope with an increasingly competitive, dynamic, unpredictable and uncertain external environment as well as responding to changes within the organisational factors. Thus we propose the following propositions:

- Performance planning mediates the relationship between contingency variables and organisational effectiveness domains.
- Performance measurement mediates the relationship between contingency variables and organisational effectiveness domains.
- PM system context mediates the relationship between contingency variables and organisational effectiveness domains.

4.2 Implications for research and practice

It is generally expected that what is learned through practice, theory and research will interweave to create the knowledge fabric for any field. Theory guides practice and research; practice enables testing of theory and generates questions for research; research contributes to theory-building and selecting practice guidelines. There are continuous calls for practitioners in the third sector to adopt PM concepts, systems, and practices from the private sector. At the same time, there are increasing numbers of empirical studies on PM and measurement in the third sector. However, a review of literature reveals that empirical studies completed on PM and organisational effectiveness in the third sector lack a well-developed theoretical rationale. A theoretical framework is a collection of interrelated concepts, like a theory but not necessarily so well worked-out (Borgatti, 1999). The theoretical framework often remains implicit in the studies without being formally articulated. Even though the completed studies are based on sound theoretical assumptions, some studies are conceptually weak and may be responsible for the conflicting findings. Herek (2011) argues that all empirical research including purely “descriptive” or “exploratory” studies necessarily involve choices about the phenomena and variables to be measured based on theoretical assumptions. Thus, there is a need for a theoretical framework that can guide future PM research in the third sector and advance a concrete theorisation in the field. More often, researchers planning an empirical study in the third sector confront the challenges of making these assumptions explicit, examining them critically, and designing the investigation to yield data that permit those assumptions to be evaluated and modified appropriately. In this paper we have addressed this gap by proposing our theoretical framework.

This paper contributes to theory-building on PM and organisational effectiveness in the third sector by developing a generic and flexible theoretical framework based on a contingency perspective, which takes into consideration the unique characteristics of the third sector. The theoretical framework will significantly strengthen future research by allowing critical evaluation of the theoretical assumptions, connecting the researchers to existing knowledge and articulating the theoretical underpinnings of the research. It will address why and how questions, and identification of the limits of theoretical generalisations. The theoretical framework specifies the key contingency

variables that influence PM and organisational effectiveness in the third sector, describing what should be measured and appropriate propositions or hypotheses. This paper further responds to previous calls in the literature to integrate several research disciplines (Chenhall, 2007; Leczy *et al.*, 2012) by combining management a accounting perspective and non-profit management perspective.

5. Conclusion

Drawing upon contingency theory, we have proposed a theoretical framework explaining how the contingency variables affect PM and organisational effectiveness in the third sector. The underlying principles for developing the theoretical framework are mainly based on the preceding theoretical justification and empirical research in management accounting and international development fields. We discussed the justification for contingency theory as well as its weaknesses in PM research. We have also highlighted how a modified PMCF could be used to identify PM in the third sector. The organisational effectiveness could be measured using four domains relevant to the organisation. The propositions are presented in three categories.

This paper is unique as it set forth a theoretical framework that creates possibilities for future research. The paper does not propose a new PM framework for the third sector but develops a theoretical framework to connect practice, theory and research on PM in the third sector. Integrating insights across disciplines, this paper strengthen cumulative knowledge on the definition and conceptualisation of PM and effectiveness within the third sector. This conceptual paper opens an opportunity for future empirical research to validate the model in a large cross-sectional study. We believe that the theoretical framework developed in this paper will be of value in the planning and conceptualisation of future PM research in the third sector.

Note

1. The third sector is also referred to as “non-governmental organisations (NGOs)”, the “voluntary sector”, “civil society organisations”, the “social economy”, the “social sector”, the “charitable sector”, “not-for-profit organisations (NPOs)”, “interest groups”, “advocacy networks”, or “social movements”, depending on context.

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