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Management Control System and Organizational Performance of Micro-finance Companies in Nepal

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Abstract

This research explores the impact of Management Control Systems (MCS) on the financial performance of Microfinance Institutions (MFIs) in Nepal. MFIs play a critical role in poverty reduction, financial inclusion, and growth promotion in their communities, and as these grow larger, sound management practices are essential to maintain financial performance. MCS - comprising budgeting, performance measurement and internal control offers the framework needed to support institutional practices in line with the strategic objectives. The research has adopted quantitative approach to explore the relationship between MCS and financial performance. A total of 150 financial managers and officers were asked to respond to structured questionnaires with a five-point Likert scale and ten MFIs were selected as a sample. Primary data was collected through Google Forms and secondary data was through academic literature, Nepal Rastra Bank publications and annual reports. The data was analyzed using descriptive statistics (mean and standard deviation), and inferential statistics (regression, correlation). The findings show that planning, monitoring and reporting are elements of MCS that positively affect the financial performance of the bank. Budgeting boosts productivity and profitability, while internal control systems effectively manage credit risk and improve profitability and loan recovery rates. This, in turn, augments the financial performance of the institution.

Keywords: *Management control system, Budgeting, Internal control system, financial performance.*

Introduction

In this context of broadening of the financial sector in Nepal, access to finance through microfinance institutions (herein referred to as MFIs) has become one of the key sources of finance in a world where poverty reduction strategies are increasingly decentralized. The recent expansion of these institutions in size and scope has also sparked debate

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about the sustainability of these institutions and their social and political roles. Thus, in this context, the role of Management Control Systems (hereafter MCS) to good governance is highlighted. They support co-ordination for an informed common operational reality across locations; control (within budget and on performance); co-creation and coherence (in relation to the mechanisms for habit formation and being tactical in relation to the strategic plan). Therefore, one may consider MCS as a compass to lead MFIs to financial autonomy and therefore maintain portfolio quality and its sustainability. MCS also enables the development of information and decision-making. They are the tools that allow managers to proactively respond to financial tides and currents and provide visibility of revenues to help them deftly navigate their course. Effective internal control underpins these processes and practices that protect assets, provide reasonable assurance that the books and records are accurate in all material respects and ensure regulatory compliance. Internal controls are also crucial for fraud prevention, accountability and restoring confidence. These also function as tools to detect risks that may adversely impact performance and stability in the short term (COSO, 2013; Basel Committee on Banking Supervision, 2012).

Another element of MCS is budgeting. Budgeting is a plan that forecasts revenue and expenses by developing a plan for how the organization will allocate resources to achieve its objectives. It enables MFIs to plan, priorities, resource and focus their efforts where they can have the greatest impact on the institution. It is also a form of financial control that enables these institutions to avoid risks, mitigate uncertainties and expand their business. These MCS components of control, monitoring, and budget planning together create an integrated design that enables both operational and strategic resilience of MFIs in Nepal. It proves to be an exercise through which MFIs can resize, reset priorities, and mitigate risks presented by clients while dealing with resource constraints. It also acts as a yardstick that leads to variance analysis for timely adjustments to management. However, according to Horngren et al. (2014), Budgeting is a bit sophisticated for most MFIs in Nepal due to technical limitations and lack of properly trained human resources.

Financial performance has, thus, been perceived as an endogenous construct in an attempt to measure support offered by MCS in earning institutional outcomes. The core firm-centered view of financial performance may be derived through the perceptions of the managers. Otherwise, a more objective set of data like ROA, ROE, net profits, and so forth may tell the same. A key measure of institutional sustainability is profitability, which is the ability to generate efficient cash flows into surpluses. This indicator is especially relevant to micro-finance institutions (MFIs) serving the low-income population since their profitability is critical to financial sustainability and market outreach. One of the key drivers of profitability is loan quality; in many instances, increasing non-performing loans (NPLs) are a major problem in the microfinance industry. This default destroys both their financial sustainability and loan repayment culture. This necessitates a professional approach to loan repayment and effective default risk mitigation strategies to contain portfolio deterioration. In this regard, effective Management Control Systems (MCS) and working internal controls have become essential tools to protect the sustainability of microfinance institutions. Institutions that successfully integrate these practices are more likely to achieve a higher financial sustainability rating, enabling them to secure stable funding and cover their operational and financing costs without excessive reliance on external grants or donations.

This will allow one, therefore, higher and rising cash flows to have a cushion just in case the market assaults.This realization will, thus, be driven by MCS, but in a zesty manner towards cost-effectiveness, expenditure control, and attached strategies that do not go astray from relevant activities. The contrast with the above may always come from the fact that those MFIs going through structured budgeting and auditing operations process are found to be financially sustainable in all cases studies (Olayemi & Akinleye, 2019). Most often, performance of MFIs working in Nepal rests on the capability of their MCS. Those organizations, which engage in formal controls, real-time reporting, and resources in budgetary digitalization, demonstrate high levels of transparency and efficiency. This is, probably, because in some organizations, tracking

in real time may have been very instrumental in bringing cost control and accounting to a new light of improvements. Those organizations that combine the audit exercise with risk management in their programs always reduce the rate of fraud. However, the major issues concerning the majority of MFIs being ineffective are size and scale of matters, crises in resources, and not establishing a standard MCS framework.

Formalized control mechanisms have been found in the research to correlate with performance. Good design of MCS tools in an organization makes it resource-constrained and still be able to meet its objectives. The concept of MCS can be applied to promote accountability in either direction of financial or social imperatives pulling in different directions to form a basis of the path for feedback on performance in an area like microfinance.

The MCS is hence, the support of an effective continuous improvement process during which accountability and performance feedback are placed. Attempting to apply MCS at the most effective point is when it is perfectly aligned with the strategy of the organization; hence, it should be evident in the budgets one brings forth, such that budgets have to match the priorities of the organization while ROIs must reflect the financial and social bottom lines. Ultimately, there is increasing interest in Nepal to combine MCS models with the social output of various organizations to increase transparency and accountability, hence strengthening sustainability.

It was all about institutional culture and leadership with proper employee engagement. MCS failures do not only come from simple gadgets that are not properly trained, coordinated, and supervised. Effective use of Blue Economy resources and their sustainability require appropriate mechanisms of multi-stakeholder cooperation in alignment with the regional ecosystem and existing governance bodies. Weaknesses to MCS are an early warning surveillance system in Nepal, need for human resource capacity, weak monitoring and technology capacities, and low levels of community ownership. The training, participatory management and more robust internal audit carried out sustainably to meet this challenge. Consequently, the spread of MCS in the

microfinance sector is now expanding and has continued to have the backing of the central bank of Nepal, other external partners, and training service providers. Indeed, both internal control systems, budgeting, and performance measures are oriented toward the design of the organization. Site-level integration in all these will definitely bring out superior performances, enhanced discipline in repayments, and survival of organizations in the long run.

It is important that relevant frameworks are designed for Nepalese MFIs within the contextual meaning, either to be responsive or inclusive on the side of financial inclusion or making creditable institutions having the poor who have been excluded. The few problems are around adoption for standard practices, auditing, and social indicators, which are below average. But it is a sad fact that no relevant study is available on the combined impact of MCS components on profitability, portfolio quality, and viability in case of Nepalese MFIs. Therefore, this research is aimed at inquiring into the ways MCS facilitates economic activities, in understanding how internal control structures and operational budgeting coupled with performance measurement affect the long-term organizational existence, and determining principal challenges that have withstood proper deployment with suggestions on remedies.

Microfinance sector is currently facing severe sustainability challenges, including rising non-performing loans (NPLs), over-indebtedness among clients, and profitability pressures due to strict interest rate caps despite the expansion of microfinance institutions (MFIs) in Nepal and their decisive role in financial inclusion. Inadequate budgeting processes, weak internal control mechanisms, and the prioritization of profit-oriented, unhealthy competition over social objectives are still visible in the sector.

Many MFIs in Nepal continue to struggle with unsound loan portfolio and oversight of on-ground business operations. As a result, it has become ever more pressing to understand the impact of control on loan quality and profitability, and the connection between different aspects of management control and the financial sustainability of the entities in the long run. Failure to address such deficiencies not only risks the long-term

financial sustainability of MFIs, but also their commitment to economically excluded groups in the long run. The study answers the following research questions. (a) What is the role of management control in influencing the perceived financial performance of microfinance companies in Nepal? (b) How do internal control and budgeting practices affect profitability and loan portfolio quality in microfinance institutions of Nepal? (c) and (d) How do different aspects of management control contribute to financial sustainability of microfinance firms in Nepal?

Literature Review

A literature review provides an organized and coherent summary of the results of previous studies on a specific topic. It outlines the current knowledge base on the subject, highlighting what is already known and what remains unknown, while showing how the present study contributes to and enhances the ongoing debate. In this context, the review explores the influence of Management Control Systems (MCS) on enhancing financial performances of Microfinance Institutions (MFIs). Controls, budgeting and performance management are identified as the main drivers of profitability, portfolio quality and sustainability for the financial microfinance sector. Drawing upon theoretical insights and empirical findings, the review mounts a strong argument that effective control systems can improve organizational efficiency and institutional performance, especially in developing countries like Nepal.

1. Management Control Theory

In The past the concept of management control theory was developed by Robert N. Anthony in about 1965 and is believed to be critical for enhancing the performance of an organization. The technique is based on formal processes that aid in the achievement of organizational goals. Accounting, control and budgeting are critical management elements. This is true of the Nepalese environment, particularly at MFIs where there is an expectation of a strong link between rigorous profitability monitoring, prudent management of scarce resources and financial discipline. That is, to the extent that they are effective, MCS enhances accountability, transparency and profitability and portfolio quality. This study was based on Anthony & Govindarajan (2007).

2. Theory of Resource-Based View (RBV)

In 1991, Jay Barney endorsed and proposed the resource-based view where valuable, rare, inimitable and non-substitutable resources underpin the potential for a sustained competitive advantage. Resources from a budgeting system, internal audits and physical monitoring among others from the MCS are significant inputs to its operations.

Conceptual Review

A conceptual review outlines the key concepts and variables that will shape a study - the structure of the research framework. This research examines the impact of management control systems, such as budgeting and internal controls, on microfinance institutions' financial performance in Nepal. Financial performance is defined as perceived results, measurement techniques, profitability, loan portfolio quality and institutional sustainability. The sections briefly expose the key concepts of the research.

1. Management Control Systems (MCS)

Management Control Systems (MCS) are the formal rules and regulations developed by an organization to control its operations and ensure resource allocation is in line with its mission. They usually include accountability systems such as budgeting, monitoring and reporting, which assist management in decision making. In the context of microfinance, MCS enhances financial discipline, increases efficiency and enhances institutional accountability. Robert N. Anthony emphasized the role of MCS in directing employees' actions towards organizational objectives. In the context of Nepalese microfinance, these systems have become increasingly crucial in financial risk management, promoting payment discipline and ensuring the financial sustainability of institutions - especially in resource scarce environment (Anthony & Govindarajan, 2007; Otley, 1999).

2. Internal Control Systems

Internal control systems are comprehensive systems that aim to ensure the integrity of financial reporting, safeguard the assets of the institution, and ensure compliance with

law and regulations. The primary elements include audit, authorization, duty segregation and real-time supervision. In microfinance, effective controls assist in preventing fraud and minimizing credit risk and assist with cultivating customer confidence. They also improve management's oversight of employees' actions and processes, and ultimately, financial performance. For MFIs in Nepal, these processes are particularly important to establish transparency and accountability in rural or remote areas (COSO, 2013; Basel Committee on Banking Supervision, 2012).

3. Budgeting

Budgeting is the process of creating financial forecasts for how much money will be earned and spent to allocate resources. It provides a fundamental tool for planning, costing and evaluation. In MFIs, budgeting is essential for synchronizing activities, forecasting future needs, and establishing accountability. This is supported by regular variance analysis which identifies the difference between what is actually performed versus what was planned and appropriate actions are taken. In MFIs in Nepal, budgeting is critical in ensuring efficient use of scarce resources and alignment of financial practices with the goals of the organization (Horngren, Datar, & Rajan, 2014; Hope & Fraser, 2003).

4. Financial Performance

Financial performance indicates how well an institution achieves its financial objectives, measured through indicators such as profitability, return on assets (ROA), sustainability and efficiency ratios. In microfinance, it also relates to the ability to deliver services in a sustainable manner. Efficiency ratios include return on equity (ROE) and operational self-sufficiency. In the Nepalese MF sector, good financial performance is essential to compete in a resource-constrained environment. Effective management control systems are important for improving performance through better strategic planning, monitoring and accountability (Ledgerwood, 1999; Campion & White, 1999).

5. Portfolio Quality

Portfolio quality measures the quality of a microfinance institution's loan portfolio. It measures Portfolio at Risk (PAR), repayment rates and borrower default rates. Good quality signifies good lending policies and practices, borrower screening and follow-up. A problematic portfolio results in profitability and vulnerability. Effective control systems mitigate credit risks by ensuring adherence to loan policies, monitoring loan repayments and timely follow-up with borrowers. For MFIs in Nepal, where formal credit history of clients does not exist, good portfolio management practices are essential to sustain their operations (CGAP, 2010; Rosenberg, 2009).

Empirical Review

Author(s) & Year	Title of Study	Methodology	Key Findings	Variables Studied
Olayemi & Akinleye (2019)	Management Control System and Financial Performance of Banks	Quantitative – Regression & Survey	MCS improves profitability, reduces inefficiency, enhances decision-making	MCS, Internal Control, Financial Performance
Adhikari & Karki (2023, Nepal)	MCS and Operational Efficiency in Nepali MFIs	Quantitative	Strong budgeting and internal controls reduce defaults and boost profitability	MCS, Budgeting, Internal Control, Profitability
Bassem (2018)	Governance and Performance in MENA MFIs	Panel Data – Regression	Budgeting and auditing improve profitability and reduce financial risks	Budgeting, Internal Control, Profitability
Yismaw& Tefera (2021)	Budgeting Practices and Financial Performance in Ethiopian MFIs	Survey and Regression	Formal budgeting improves expense control and profitability	Budgeting, Profitability
Shrestha &Adhikari (2020, Nepal)	Budgeting and Financial Sustainability in MFIs	Descriptive and Inferential Statistics	Structured budgeting improves cost control and resource allocation	Budgeting, Financial Viability

KC & Poudel (2025, Nepal)	MCS and Financial Performance in Nepali MFIs	Survey-based Regression	Strong MCS improves perceived financial performance and portfolio management	MCS, Budgeting, Financial Viability
Adekunle (2016)	Impact of MCS on Nigerian MFIs Cross-sectional Survey		Effective MCS reduces fraud, supports profitability	MCS, Portfolio Quality, Profitability
Basnet (2022, Nepal)	Internal Control and Loan Performance in Rural MFIs	Correlation and Regression	Weak internal control raises defaults; audits improve repayment	Internal Control, Portfolio Quality
Wondwossen& Samuel (2017)	Performance Measurement and MFI Sustainability	Mixed Methods	Performance reviews improve ROA and efficiency	Performance Measurement, Financial Viability
Alsharari et al. (2020)	Internal Control in Public Sector Performance	Survey	Strong internal controls enhance transparency and performance	Internal Control, Financial Performance
Asmamaw & Abate (2018)	Budgeting and Performance in Ethiopian MFIs	Quantitative	Activity-based budgeting improves planning and cost management	Budgeting, Financial Planning
Timsina & Paudel (2019, Nepal)	Performance Measurement in Nepali MFIs	Survey and Regression	Performance tools improve profitability and retention	Performance Measurement, Profitability
Kebede (2015)	Internal Control in Ethiopian MFIs	Quantitative	Control weaknesses cause financial losses; fraud detection improves viability	Internal Control, Financial Viability
Sharma & Bhandari (2021, Nepal)	MCS and Institutional Efficiency in MFIs	Audits and Interviews	Control systems reduce overhead and improve portfolio performance	MCS, Internal Control, Portfolio Quality

Kassaye & Abera (2020)	Internal Audits and MFI Performance	Quantitative	Frequent audits reduce credit risk and enhance repayments	Internal Control, Risk, Portfolio Quality
Dhungana & Rijal (2024, Nepal)	Perceived Performance and Budgeting in Small MFIs	Quantitative	Budget reviews aligning strategic control and decision-making	Budgeting, Perceived Performance
Mohammed & Ismael (2019)	Portfolio Quality and MCS in Sudanese MFIs	Field-based	Real-time loan tracking reduces delinquencies	MCS, Portfolio Quality
Regmi & Karki (2023, Nepal)	Budgeting and Performance in Cooperative MFIs	Case Study	Strategic budgeting improves efficiency and growth	Budgeting, Financial Performance
Girma & Tadesse (2022)	Control Systems and Portfolio Risk	Quantitative	Risk indicators improve repayment and satisfaction	Internal Control, Portfolio Quality
Thapa & Gurung (2025, Nepal)	MCS and Financial Viability in Nepali MFIs	Survey and Regression	Budgeting and audits improve resilience and reduce defaults	MCS, Budgeting, Financial Viability

Research Gap

While the world has shown an increasing interest in the impact of management control systems, internal controls and budgeting in financial performance, this has been largely untapped in Nepalese microfinance institutions (MFIs). Overall, this literature seems to be focused on commercial banks and international development financial institutions, but this ignores the different challenges and constraints faced by Nepalese MFIs. While a few studies attend to particular components of MCS, say, like auditing or budgeting, none really gives an aggregated analysis of how all such elements combine in the MCS to affect financial indicators, inter alia, profitability, loan portfolio strength, and institutional reliability (Olayemi & Akinleye, 2019; Yismaw& Tefera, 2021).

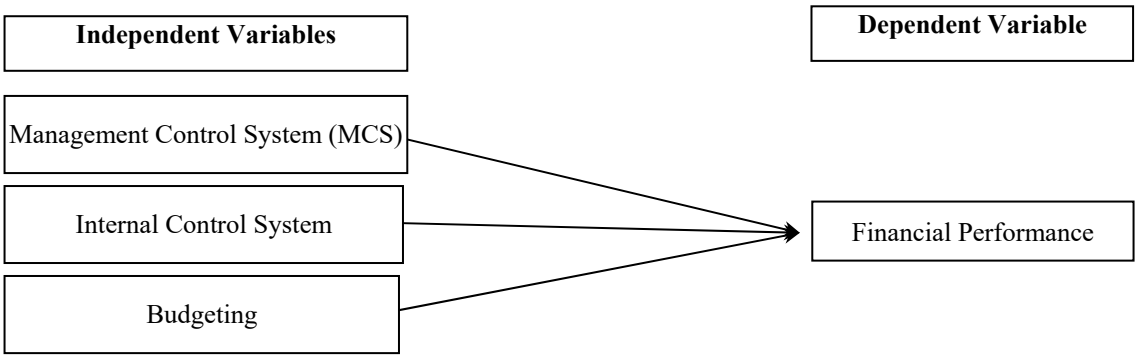
In all, most of the empirical work on Nepalese MFIs is thin in construct, and much reliance is based on descriptive approaches rather than advanced statistical methods to establish cause and Effect relationships. Another gap is in missing the perceived financial outcomes and non-financial dimensions of the evaluation of institutional effectiveness. This links back to what was raised earlier about perceived financial results and non-financial dimensions of institutional effectiveness.

Since most of these operations are based in rural and semi-formal setups in Nepal, the variance in the financial literacy levels and observance of regulatory bodies among clients is quite large. Accordingly, it is important to study how budgeting system and the internal control systems shape performance (Basnet, 2022; Dhungana & Rijal, 2024).

This study fills the gap in the above research by inferring an integrated and empirical examination of the link between MCS and financial performance of MFIs in Nepal. It combines both objective and subjective performance measures, done through descriptive and inferring statistics simultaneously. Thus, the research sought to provide some implications for the managers, regulators, and policy makers to achieve more efficiency, governance and sustainability by adopting effective control systems.

Figure 1

Conceptual Framework



Independent and Dependent Variables

Variable Type	Variable Name	Explanation
Independent Variable	Management Control System (MCS)	Management Control System (MCS) is a set of formal processes and practices to coordinate employees' efforts with the financial and strategic goals of institutions. This includes aspects such as planning, monitoring and review. For microfinance institutions (MFIs), MCS serves as a coordination tool to enhance decision-making, allocation and efficiency. MCS mitigates risks, improves accountability and internal discipline. In the case of Nepalese MFIs, these systems help them ensure financial control and drive better performance (Anthony & Govindarajan, 2007; Otley, 1999).
Independent Variable	Internal Control System	Internal controls are policies and procedures put in place to safeguard assets, comply with laws and regulations and reduce errors in financial transactions. These are audits, risk management, authorizations and monitoring. Internal controls are crucial for microfinance institutions as they reduce the risk of frauds, errors and misstatements. In a country like Nepal where MFIs operate in remote and decentralized regions, internal control measures ensure accountability and trust and facilitate financial sustainability. These processes have a transparency effect and "serve as a foundation for the credibility of the institution" (COSO, 2013; Basel Committee, 2012).
Independent Variable	Budgeting	Budgeting refers to financial planning for resource allocation according to the objectives and priorities of the organization. It is an important control mechanism in MFIs as it projects revenues and expenditure to inform decision making.
Dependent Variable	Financial Performance	Budgeting is an important financial control mechanism and crucial for planning and sustainability. Any good system sets goals, encourages scrutiny and discipline in financial dealings. An example of such a system is formal budgeting systems, which are used to achieve targets, spending control and move towards long-term goals in Nepalese MFIs (Horngren et al., 2014; Hope & Fraser, 2003).

Methodology

This study adopts a quantitative research design and uses both descriptive and causal-comparative research designs to investigate the impact of management control systems on the financial performance of microfinance institutions in Nepal. The population includes all registered MFIs in Nepal, from which a sample of ten MFIs were selected, taking into account the age and geographical spread of the institutions. The research gathered information from 150 managers and officers in charge of finance through a questionnaire based on a five-point Likert scale. Primary data were collected via Google Forms, and secondary data via annual reports, Nepal Rastra Bank publications and academic papers. The model comprises three independent variables management control systems, internal control mechanisms, and budgeting and one dependent variable financial performance, measured by perceived performance, practices of measurement, profitability, quality of the portfolio of loans and long-term sustainability (Anthony & Govindarajan, 2007). Descriptive statistics (mean, standard deviation, frequency distribution) and inferential techniques (correlation, multiple regression) were used to summaries the data and assess the relationship between the variables, respectively. The data were analyzed using statistical software SPSS, and a 95 percent confidence level was used to test the hypotheses (Field, 2013).

Table 1

Descriptive Analysis of Management Control System (MCS)

Statement	Mean	S. D
1. Our institution has clearly defined control procedures for achieving strategic goals.	3.15	1.38
2. Managers regularly review performance against set targets.	2.76	1.40
3. There is a formal system to track departmental performance.	3.02	1.45
4. Feedback and corrective actions are part of our control practices.	3.15	1.49
5. Control systems are aligned with organizational policies and objectives.	2.95	1.46

The results in Table 1 show that the management control system (MCS) of microfinance institutions in Nepal is at an intermediate level. The highest agreement among the respondents was regarding the presence of well-defined operational procedures and formal feedback mechanisms, with mean scores of 3.15. Conversely, the processes related to performance reviews (Q2) appeared to be less developed, with the lowest mean score of 2.76. The relatively consistent standard deviations around 1.4 observed across variables reflect the variability across MFIs. Overall, these findings show that while certain control elements are present, their potential effectiveness may be compromised by variable implementation among institutions - a conclusion that adds to the study's argument about enhancing MCS and its subsequent impact on organization and financial performance.

Table 2

Descriptive Analysis of Internal Control System (ICS)

Statement	Mean	S.D
1. Regular internal audits are performed in our institution	2.92	1.42
2. There is a segregation of duties for risk and fraud prevention.	3.02	1.42
3. Financial statements are reviewed and verified by various parties.	2.95	1.46
4. There are defined approval levels for financial transactions.	2.89	1.42
5. Risks are managed and assessed.	3.08	1.44

The evidence in Table 2 suggests that internal control systems are only moderately adopted in Nepal's microfinance sector. Interestingly, among the five indicators, the highest mean score (3.08) was observed in the component of internal control practices relating to proactive risk identification and management, suggesting it is the most common internal control practice. In contrast, the lowest mean score of 2.89 was obtained for approval authority of financial transactions, which reflects somewhat weaker control in authorizing financial transactions. The other indicators (frequent internal audit (Mean = 2.92), segregation of duties (Mean = 3.02), and multi-party

review of financial reports (Mean = 2.95)) were all found to lie in a narrow middle zone - meaning that the overall level of internal control implementation is almost moderate. Relatively high standard deviations (around 1.4) across all items suggest considerable variability between institutions in the adoption of these practices. Overall, these results imply that whilst the basic components of internal control practices are in place in Nepal's microfinance sector, their sporadic nature of adoption may put a limit on their effectiveness - thus justifying the rationale of the current study, which is to focus on strengthening the internal control systems of these institutions as a way to improve financial performance.

Table 3

Descriptive Analysis of Budgeting

Statement	**Mean**	**S.D**
1: Annual budgets are prepared in a structured and timely manner.	2.89	1.41
2: Budget plans are aligned with strategic and operational goals.	3.17	1.40
3: Budget performance is reviewed regularly by management.	2.99	1.44
4: Variance analysis is conducted to assess actual vs. budgeted performance.	2.95	1.45
5: Department heads are involved in the budgeting process.	3.25	1.40

Table 3 suggests that budgeting practices in microfinance institutions in Nepal are fairly well-developed. The highest mean score (3.25) for Q5 indicates a strong practice of involving individual departments in the budgeting process, implying that heads of those departments are active participants in the decision-making process. In contrast, the lowest mean score of 2.89 for Q1 points to less formal budget preparation, suggesting there is still potential for improvement. Standard deviations around 1.4 for all items suggest a relatively high degree of variability in the adoption of budgeting practices across the institutions. Overall, these findings highlight a need to create more structured and disciplined budgeting practices to lay the groundwork for improved financial performance - a major focus of this study.

Table 4

Descriptive Analysis of Performance Measurement

Statement	Mean	S. D
1. Key financial performance indicators are clearly defined and used.	3.25	1.38
2. Performance results are shared across departments.	2.91	1.41
3. Financial performance is evaluated against set benchmarks.	3.05	1.47
4. Our institution uses both financial and non-financial metrics for evaluation.	3.01	1.38
5. Management uses performance data for decision-making.	3.01	1.48

Table 4 shows that performance management practices are moderately practiced in microfinance institutions in Nepal. Q1 has the highest mean score (3.25), suggesting that indicators of financial performance are quite clear and are in use in these institutions. On the other hand, Q2 has the lowest mean with 2.91, implying that there is a significant gap in effective performance data-sharing between departments which must be improved. The standard deviations of around 1.4 for the indicators indicate there is moderate variability in the extent of performance measurement practices across institutions. These results highlight the need to strengthen practices of performance measurement as a key approach to improving microfinance institutions' performance.

Results

The research found a strong positive association between management control systems and financial performance of microfinance institutions in Nepal.MFI having formal MCS (planning, monitoring and reporting) showed better perceived financial performance (Anthony & Govindarajan, 2007). Internal control systems improved profitability and portfolio performance by minimizing loan defaults and improving discipline (COSO, 2013; Basel Committee, 2012). Budgeting also positively influenced profitability, as budgeting helps to control costs (Horngren et al., 2014).

Table 5

Correlation Analysis

Variables	MCS	ICS	Budgeting	PM
MCS	1.00			
ICS	0.61**	1.00		
Budgeting	0.58**	0.57**	1.00	
PM	0.65**	0.59**	0.62**	1.00

The variables are all moderately linked (Table 5). The highest correlation (0.65) is between MCS and PM, so better control systems lead to better performance monitoring. ICS also enhances budgeting and evaluation. This justifies the paper's emphasis on control systems' effect on financial performance.

Table 7

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.573	0.328	0.289	0.372

The model explains 32.8% of the change in financial performance (Table 7). The R (0.573) value suggests a positive correlation between the variables, and the model is a good fit.

Table 10

ANOVA

Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	3.205	4	0.801	8.491	0.000
Residual	20.358	146	0.139		
Total	23.563	150			

As shown in Table 10, the overall regression model has a significant effect with F-value of 8.491 and significance (p-value) of 0.000. It implies that the overall effect of management control system, internal control system, budgeting and performance measurement has an effect on financial performance.

Table 10

Coefficients Analysis

Model	Unstandardized Coefficients (B)	Std. Error	Standardized Coefficients (Beta)	t	Sig.
(Constant)	3.29	0.50		6.56	0.000
MCS	-0.17	0.08	-0.24	-2.05	0.042
ICS	0.06	0.07	0.10	0.88	0.378
Budgeting	0.00	0.09	0.00	0.00	0.998
PM	0.01	0.09	0.02	0.16	0.875

In table 10, it can be seen that only the management control system (MCS) is significantly and negatively impacting financial performance (Beta = -0.24, p = 0.042). The other variables - internal control system, budgeting and performance measurement - do not significantly affect financial performance, with their p-values greater than 0.05.

Discussion

This research provided valuable information on the Management Control Systems (MCS) of Nepalese microfinance institutions (MFIs). It found institutional management is underpinned by three key factors: internal controls, budget and performance measurement. In general, most MFIs were found to have fairly developed control systems, particularly for budgeting which has adopted formal practices. Greater variability was evident in the practice of performance measurement. Respondents showed the highest agreement to all the statements on the clear standard operating procedures and feedback mechanisms and were relatively less satisfied with the systematic use of performance reviews.

Overall, the effectiveness of control systems was satisfactory, with internal controls being the highest rated assessed in this study. Active risk management was positively rated, but shortcomings were detected in the approval process (soft or weak controls in this area). However, budgeting processes were more advanced. Department heads were

actively involved in this process and showed ownership of, and commitment to, the budgeting process. Nonetheless, the preparation of the budget tended to be more formalized, with minimal opportunities for consultation and involvement between units.

In terms of performance management, financial performance measures were the most commonly emphasized and well-defined. But we found that the sharing and diffusion of performance information within units was insufficient which prevented greater knowledge-learning and coordinated decision-making.

The statistical findings also measured relationships between the independent variables, with the highest direction between management control systems (MCS) and performance evaluation (PE). This may indicate more stringent control systems are associated with better monitoring and evaluation of performance outcomes. Using regression analysis, we also confirmed the presence of a strong link between financial performance and management control systems, although the short-term impact of internal controls, budgeting and performance measurement individually was less significant. While the model explained 32.8% of the variation in financial performance, the findings suggest a strong integrated control system is important for improving institutional efficiency.

Taken together, the results speak to the role of MCS in influencing financial performance among the MFIs in Nepal. Improved control systems not only enhance profitability but also protect portfolio quality - a critical factor that defines the survival chances of institutions. The findings also point to the need to build institutional capacity in terms of knowledge in internal auditing, budgeting, and performance measurement and ensure their alignment with institutional strategy. Enhancing these skills can support a microfinance sector in Nepal which is more efficient, robust and sustainable in the long run.

Conclusion

This study examined the various components of Management Control Systems (MCS) i.e internal controls, budgeting and performance measurement - and their relative impact

on the financial bottom-line of microfinance institutions (MFIs) in Nepal. The statistical descriptive analysis revealed that although basic control processes are in place within most of the sample institutions, the level of adoption is not high, and there is considerable institutional variability in the level of adoption and effectiveness of implementation.

Budgeting was found to be the most adopted among the three components of MCS investigated, with the highest mean score of 3.74 (SD = 0.62). This is reflected in active involvement of department heads in process of resource allocation and management and indicates that budgeting has become relatively institutionalized in the decision-making structures of MFIs. Internal control systems were the second most adopted component, with a mean score of 3.62 (SD = 0.68). In this category, 52 percent of respondents strongly agreed that the transaction approval procedures were rigorously followed, while relatively higher proportion (68 percent) acknowledged that the proactive risk management measures were efficiently implemented.

By contrast, the dimension with the lowest mean score was performance measurement, indicating that this element is the weakest of those evaluated. Notably, 46 percent of respondents strongly agreed that performance results were regularly shared and disseminated throughout the different divisions of their respective institutions, suggesting a significant lack of functional integration and information sharing.

These results collectively suggest that while Nepalese MFIs have set in place basic management control systems, these systems are being implemented unevenly and, in some instances, not rigorously. These findings highlight a pressing need for greater coherence, transparency and strategy alignment in the application of MCS components - the answer to improving institutional, managerial and financial performance (Anthony & Govindarajan, 2007).From the results of correlation analysis, all variables in the study were found to be generally positively related to one another, but the strength depended on the association. The correlation between MCS WM and perf meas WM was very high at $r = 0.65$, $p < 0.01$, showing that institutions that had well-developed meaning

systems would also hold an easily systematic way of monitoring. There was a moderate positive relationship with internal control systems, both in budgeting, $r = 0.58$, $p < 0.01$, and performance appraisal, $r = 0.55$, $p < 0.01$. Basically, systems would be generally interdependent in organizational structures. On its part, financial performance moderately related positively to all the independent variables; hence, it can be affirmed that each factor has its contribution to outcomes, though not consistently. These findings re-emphasized the argument that, among the MFIs, financial sustainability is secured in the proper operation of control systems taken as a whole, and not isolated practices but combined in strength (COSO, 2013; Basel Committee, 2012).

In this case, since the variables are statistically low, a regression analysis would equally go a long way to help bring out the cause-and-effect relationship that exists regarding MCS and financial performance. The model explained 32.8% of the variance in financial performance ($R^2 = 0.328$, Adjusted $R^2 = 0.312$, $F = 12.45$, $p < 0.001$); that is a moderate level of explanation. No association was found between the beta values for internal control, budgeting, and measuring performance. All are positive but not significant, showing that each of his elements would input financial discipline, though not able to confirm performance improvement unless they are integrated into some bigger system. It only further suggests that it is in contextual adaptation, not the rigid enforcement of formal structure (Field, 2013; Olayemi & Akinleye, 2019).

Practical and Policy Implications for the Microfinance Sector of Nepal

The findings will have practical and policy implications for the microfinance sector in Nepal. It will give policy implication to regulatory bodies such as Nepal Rastra Bank to mainstream standardized MCS at all levels and to capacitate more personnel on matters of auditing, budgeting, and performance monitoring at both institutional and national levels. The other implication for the practitioners is that the control systems should not be very rigid, but flexible depending on the size of the institution, market conditions, and the availability of resources. Risk management, participatory budgeting and information about performance for departmental reporting are the ways to achieve better

financial performance. The findings show that MCS is vital to forecast the financial performance, which is profit, portfolio quality and sustainability of the company, though it's complicated. So, the key to sustainable growth in the microfinance industry of Nepal is to enhance effective resilience with improved connections among controls at the bottom and flexibility (Shrestha & Adhikari, 2020; Thapa & Gurung, 2025).

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Questionnaire

Section A: Demographic Information

1. What is your job title in the microfinance institution?

- ☐ BranchManager
- ☐ Finance Officer
- ☐ Internal Auditor
- ☐ Administrative Staff
- ☐ Other (please specify): _____

2. How long have you been in the microfinance industry?

- ☐ Less than 2 years
- ☐ 2−5 years
- ☐ 6−10 years
- ☐ More than 10 years

3. What is your highest level of education?

- ☐ High School
- ☐ Bachelor′s Degree
- ☐ Master′s Degree or above
- ☐ Professional Certification (e.g., CA, ACCA)
- ☐ Other (please specify): _____

4. In which province is your institution located?

- ☐ Province 1
- ☐ Madhesh
- ☐ Bagmati
- ☐ Gandaki
- ☐ Lumbini
- ☐ Karnali
- ☐ Sudurpaschim

5. What is the type of microfinance institution you work in?

- ☐ Private Microfinance Company
- ☐ Cooperative-based MFI
- ☐ Government-affiliated MFI
- ☐ NGO/INGO-supported MFI
- ☐ Other (Please specify): .....

Section B: Variables-Based Questions

Please tick the option that best represents your agreement with each statement.
(1 = Strongly Disagree , 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)

Variable	Statements	1	2	3	4	5
1. Management Control System (MCS)	**1:** Our institution has clearly defined control procedures for achieving strategic goals.					
	2: Managers regularly review performance against set targets.					
	3: There is a formal system to track departmental performance.					
	4: Feedback and corrective actions are part of our control practices.					
	5: Control systems are aligned with organizational policies and objectives.					
2.InternalControl System	**1:** Internal audits are conducted regularly in our institution.					
	2: Segregation of duties exists to minimize risk and fraud.					
	3: Financial reports are reviewed and verified by multiple parties.					
	4: There are defined approval levels for financial transactions.					
	5: Risks are identified and managed proactively.					
3. Budgeting	**1:** Annual budgets are prepared in a structured and timely manner.					
	2: Budget plans are aligned with strategic and operational goals.					

	3: Budget performance is reviewed regularly by management.					
	4: Variance analysis is conducted to assess actual vs. budgeted performance.					
	5: Department heads are involved in the budgeting process.					
4. Perceived Financial Performance	**1:** Our institution is financially stable based on management's assessment.					
	2: Staff believe that the organization is operating profitably.					
	3: The current financial position is considered satisfactory by top management.					
	4: Financial targets are usually met as planned.					
	5: Management has a positive outlook on future financial trends.					
5. Performance Measurement	**1:** Key financial performance indicators are clearly defined and used.					
	2: Performance results are shared across departments.					
	3: Financial performance is evaluated against set benchmarks.					
	4: Our institution uses both financial and non-financial metrics for evaluation.					
	5: Management uses performance data for decision-making.					

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