PART 5
Controlling

CHAPTER 14
Basic Elements of Control
Chapter Learning Objectives

After studying this chapter you should be able to:

1. Explain the purpose of control, identify different types of control, and describe the steps in the control process.
2. Identify and explain the three forms of operations control.
3. Describe budgets and other tools for financial control.
4. Identify and distinguish between two opposing forms of structural control.
5. Discuss the relationship between strategy and control.
6. Identify characteristics of effective control, why people resist control, and how managers can overcome this resistance.
The Nature of Control

• **Control**
  – The regulation of organizational activities in such a way as to facilitate goal attainment
  – The regulation of organizational activities so that some targeted element of performance remains within acceptable limits.

• **Purposes of Control**
  – Provides organizations with indications of how well they are performing in relation to their goals.
  – Provides a mechanism for adjusting performance to keep organizations moving in the right direction.
The Planning–Controlling Link

Organizing/Leading

Planning ➔ Controlling ➔ Planning ➔ Controlling

Organizing/Leading

Planning

Controlling

Organizing/Leading
FIGURE 14.1 The Purpose of Control

Adapt to environmental change

Limit the accumulation of error

Control helps the organization

Cope with organizational complexity

Minimize costs

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Controls

Areas of Control

- Physical Resources
- Human Resources
- Information Resources
- Financial Resources
## Types of Controls

<table>
<thead>
<tr>
<th>Areas of Control</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Physical resources</td>
<td>Inventory management, quality control, and equipment control.</td>
</tr>
<tr>
<td>Human resources</td>
<td>Selection and placement, training and development, performance appraisal, and compensation.</td>
</tr>
<tr>
<td>Information resources</td>
<td>Sales and marketing forecasts, environmental analysis, public relations, production scheduling, and economic forecasting.</td>
</tr>
<tr>
<td>Financial resources</td>
<td>Managing capital funds and cash flow, collection and payment of debts.</td>
</tr>
</tbody>
</table>
FIGURE 14.2 Levels of Control

- Strategic control
- Structural control
- Operations control
- Financial control
Responsibilities for Control

• Managers are accountable for and involved in activities for which control is their responsibility.

• Controller
  – A position in organizations that helps line managers with their control activities.
Responsibility for Control

CEO

Corporate Controller

Division Head

Division Controller

Division Head

Division Controller

Division Head

Division Controller
FIGURE 14.3 Steps in the Control Process

1. Establish standards
2. Measure performance
3. Compare performance against standards
4. Determine need for corrective action

- Maintain the status quo
- Correct the deviation
- Change standards
Steps in the Control Process

• Establishing Standards
  – Control standard is a target against which subsequent performance will be compared.
    • Should be expressed in measurable terms.
    • Should be consistent with organizational goals.
    • Should be identifiable indicators of performance.

• Measuring Performance
  – Performance measurement is an ongoing process.
  – Performance measures must be valid indicators (e.g., sales, costs, units produced) of performance.
Steps in the Control Process (cont’d)

• Comparing Performance Against Standards
  – Define what is a permissible deviation from the performance standard.
  – Utilize the appropriate timetable for measurement.

• Considering Corrective Action
  – Maintain the status quo (do nothing).
  – Correct the deviation to bring operations into compliance with the standard.
  – Change the standard if it was set too high or too low.
FIGURE 14.4 Forms of Operations Control

Feedback

Inputs

Preliminary control
Focus is on inputs to the organizational system.

Transformation

Screening control
Focus is on how inputs are being transformed into outputs.

Outputs

Postaction control
Focus is on outputs from the organizational system.
Financial Control

• Control of financial resources (e.g., revenues, shareholder investment) as they:
  – Flow into the organization
  – Are held by the organization as working capital and retained earnings
  – Flow out of the organization as payment of expenses.
• **Budgetary Control**

  – Budgets may be established at any organizational level.

  – Budgets are typically for one year or less.

  – Budgets may be expressed in financial terms, units of output, or other quantifiable factors.
Purposes of Budgets

• Help coordinate resources and projects.
• Help define the established standards for control.
• Provide guidelines about resources and expectations.
• Evaluate the performance of managers and organizational units.
Management Challenge Question

• How can budgetary controls help prevent conflicts in organizations?
Types of Budgets

Financial Budgets
- Cash flow or cash budget
- Capital expenditures budget
- Balance sheet budget

Operating Budgets
- Sales and revenue budget
- Expense budget
- Profit budget

Nonmonetary Budgets
- Labor budget
- Space budget
- Production budget
<table>
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<tr>
<th>Types of Budget</th>
<th>What Budget Shows</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial Budget</strong></td>
<td><strong>Sources and Uses of Cash</strong></td>
</tr>
<tr>
<td>Cash-flow or cash budget</td>
<td>All sources of cash income and cash expenditures in monthly, weekly, or daily periods</td>
</tr>
<tr>
<td>Capital expenditures budget</td>
<td>Costs of major assets such as a new plant, machinery, or land</td>
</tr>
<tr>
<td>Balance sheet budget</td>
<td>Forecast of the organization’s assets and liabilities in the event all other budgets are met</td>
</tr>
<tr>
<td><strong>Operating Budget</strong></td>
<td><strong>Planned Operations in Financial Terms</strong></td>
</tr>
<tr>
<td>Sales or revenue budget</td>
<td>Income the organization expects to receive from normal operations</td>
</tr>
<tr>
<td>Expense budget</td>
<td>Anticipated expenses for organization during coming time period</td>
</tr>
<tr>
<td>Profit budget</td>
<td>Anticipated differences between sales or revenues and expenses</td>
</tr>
<tr>
<td><strong>Nonmonetary Budget</strong></td>
<td><strong>Planned Operations in Nonfinancial Terms</strong></td>
</tr>
<tr>
<td>Labor budget</td>
<td>Hours of direct labor available for use</td>
</tr>
<tr>
<td>Space budget</td>
<td>Square feet or meters of space available for various functions</td>
</tr>
<tr>
<td>Production budget</td>
<td>Number of units to be produced during the coming time period</td>
</tr>
</tbody>
</table>
FIGURE 14.5 Developing Budgets in Organizations

- Operating unit budget requests
- Division budget requests
- Organizational budget
  - Prepared by budget committee
  - Approved by budget committee, controller, and CEO
Strengths and Weaknesses of Budgeting

• Strengths
  – Budgets facilitate effective operational controls.
  – Budgets facilitate coordination and communication between departments.
  – Budgets establish records of organizational performance, which can enhance planning.

• Weaknesses
  – Budgets can hamper operations if applied too rigidly.
  – Budgets can be time consuming to develop.
  – Budgets can limit innovation and change.
Other Tools of Financial Control

• Financial Statements
  – A financial statement is a profile of some aspect of an organization’s financial circumstances.
  – Balance sheet
    • A listing of assets (current and fixed), liabilities (short- and long-term), and stockholders’ equity at a specific point in time (typically year-ending) that summarizes the financial condition of the organization.
  – Income statement
    • Summary of financial performance—revenues less expenses as net income (i.e., profit or loss)—over a period of time, usually one year.
• **Ratio Analysis**
  
  – Is calculation of financial ratios to assess some aspect of the organization’s financial health.

  • **Liquidity ratios** show how readily the firm’s assets can be converted to cash.

  • **Debt ratios** reflect the firm’s ability to meet long-term financial obligations.

  • **Return ratios** show how much investment return the firm is generating relative to the value of its assets.

  • **Coverage ratios** estimate the ability of the firm to pay the interest expenses on money it has borrowed.

  • **Operating ratios** demonstrate the efficiency of the firm’s functional operations.
Other Tools of Financial Control (cont’d)

• Financial Audit
  – Is an independent appraisal of an organization’s accounting, financial, and operational systems.
    • External audits—financial appraisals conducted by experts who are not employees of the organization.
    • Internal audits—appraisals conducted by employees of the organization.
• **Bureaucratic Control**
  – A form of organizational control characterized by formal and mechanistic structural arrangements.

• **Decentralized Control**
  – An approach to organizational control characterized by informal and organic structural arrangements.
FIGURE 14.6 Organizational Control

Bureaucratic Control
- Employee compliance
- Strict rules, formal controls, rigid hierarchy
- Directed toward minimum levels of acceptable performance
- Tall structure, top-down influence
- Directed at individual performance
- Limited and formal

Dimension
- Goal of control approach
- Degree of formality
- Performance expectations
- Organization design
- Reward system
- Participation

Decentralized Control
- Employee commitment
- Group norms, culture, self-control
- Directed toward enhanced performance above and beyond the minimum
- Flat structure, shared influence
- Directed at group performance
- Extended and informal
Integrating Strategy and Control

• **Strategic Control**
  – Aims at maintaining an effective alignment with the environment and achieving strategic goals.
  – Focuses on structure, leadership, technology, human resources, and informational and operational systems.
  – Focuses on the extent to which an implemented strategy achieves the organization’s goals.
• International Strategic Control
  – Focuses on whether to manage the global organization from a centralized or decentralized perspective.

• Control Choice: Centralization or Decentralization
  – Centralization creates more control and coordination, whereas decentralization fosters adaptability and innovation.
Managing Control in Organizations

Characteristics of Effective Controls

- Integration with planning
- Flexibility
- Accuracy
- Timeliness
- Objectivity
### Characteristics of Effective Control

<table>
<thead>
<tr>
<th>Integration with Planning</th>
<th>The more control is linked to planning, the more effective the control system.</th>
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</thead>
<tbody>
<tr>
<td>Flexibility</td>
<td>The control system must be flexible enough to accommodate change.</td>
</tr>
<tr>
<td>Accuracy</td>
<td>Inaccurate information results in bad decision making and inappropriate managerial actions.</td>
</tr>
<tr>
<td>Timeliness</td>
<td>A control system should provide information as often as necessary.</td>
</tr>
<tr>
<td>Objectivity</td>
<td>A control system must be free from bias and distortion.</td>
</tr>
</tbody>
</table>
Sources of Resistance to Control

- Overcontrol
- Inappropriate Focus
- Rewards for Inefficiency
- Too Much Accountability
Resistance to Control

• **Overcontrol**
  – Trying to control too many details affects employee behavior when employees perceive control attempts as unreasonable.

• **Inappropriate Focus**
  – The control system may be too narrow or it may focus too much on quantifiable variables and leave no room for analysis or interpretation.
Resistance to Control (cont’d)

• Rewards for Inefficiency
  – Rewarding operational inefficiency can lead employees to behave in ways that are not in the best interests of the organization.

• Too Much Accountability
  – Efficient controls are resisted by poorly performing employees.
Overcoming Resistance to Control

- Design controls properly integrated with organizational planning and aligned with the organization’s goals and standards.
- Create flexible, accurate, timely, and objective controls.
- Avoid overcontrol in implementation of controls.
- Guard against controls that reward inefficiencies.
- Encourage employee participation in the planning and implementing of control systems.
- Develop a system of checks and balances to verify the accuracy of performance indicators.