

Management Control



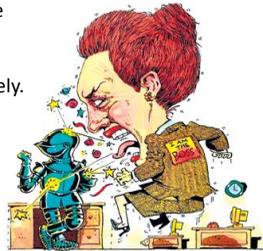
Well, how much control do we get then!?

Chapter 4

MCS Critical for Management Function

Management Control Systems are aimed to ensure that the organization's objectives and strategies are carried out effectively.

- Management control systems increase the likelihood of organizational success if the implementation is appropriate.



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Tight Control is Good Control?

- "Good control" is said to take place when there is ...
 - a "high" probability that the firm's objectives will be achieved;
 - a "low" probability that major unpleasant surprises will occur.
- Hence, the benefit of a control system can be expressed in terms of the *amount of control* achieved.
- In this respect, *tight control* is "good" if it provides "high" probability that *that people will act as the organization wishes* (assuming no harmful side-effects ...).

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Tight Control is Good Control? (cont.)

- Major management decision!
 - Tightness of individual control mechanisms.
 - Tightness of collection of mechanisms – the control system.
- Both tight and loose control are associated with direct and indirect *costs*.
- Tightness requires significant managerial *knowledge* of the object of control.

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3 Drivers of Tightness

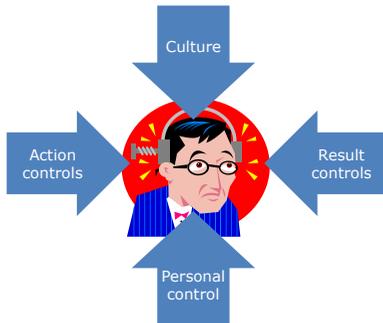
Tight control: when controls are

- detailed
- applied frequently
- low acceptance of non-compliance



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Tightness is the Effect of Combined Controls



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Tight Action Controls

Behavioral constraints:

- Physical constraints
 - Extra protection usually costs more.
- Administrative constraints
 - Restricting decision making to higher organizational levels provides tighter controls if:
 - Higher-level personnel can be expected to make more reliable decisions;
 - Those who do not have authority cannot violate the constraints.



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Tight Action Controls (cont.)

Preaction reviews

- Become tighter if the reviews are frequent, detailed, and performed by diligent, knowledgeable persons.



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Tight Action Controls (cont.)

Holding employees *accountable* for actions requires:

- *Defining* what actions are (un)acceptable
- *Communicating* these definitions to employees
 - Administratively (rules, policies, procedures, codes of conduct) or socially
- *Observing* or otherwise tracking what happens
 - Direct observation / supervision
 - Periodic tracking (e.g., "mystery shoppers")
 - Evidence of actions taken (e.g., activity reports)
- (Rewarding good actions, or) punishing actions that deviate

➤ Potentially addresses all three control problems!

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Are Loose Action Controls Effective?

- Can be harmful if not accompanied by personnel controls (e.g., selection, training)
- May create ambiguity and confusion.
- Loose action controls often stifle action, while selectively used and *tight action controls can enhance managers' autonomy and entrepreneurial spirit*:

➤ "Everything that is not explicitly forbidden is allowed."

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Tight Result Controls

Tight results controls rely on:

- highly *specific* and realistic budgetary goals, *frequent* and *detailed* reporting feedback, *complete* performance measures directly linked to *rewards*.
1. The definitions of results areas
 2. The performance measures
 3. The reinforcements provided



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Definition of Desired Results Areas

1. Congruence
 - Choosing measurable performance dimensions that reflect an organization's "true" objectives;
 - # visitors for the success of a museum?
 - # of patents for the success of R&D-departments?
 - Annual profits for a firm with significant growth ambitions?
2. Specificity
 - Disaggregation + quantification;
 - e.g., "keep customers happy" vs. "less than 1 pct. customer complaints."



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Definition of Desired Results Areas (cont.)

3. Communication and internalization
 - qualification of the personnel involved;
 - the amount of participation in the goal-setting process;
 - the perceived degree of controllability; and,
 - the reasonableness of the goals.
4. Completeness
 - What you measure is what you get !
 - Hence, when the defined results areas are incomplete, performance in the unmeasured areas is likely to slip.



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The Performance Measures

- Precision (cf., amount of “noise”)
- Objectivity (cf., freedom of “bias”)
- Timeliness
 - Refers to the *time lag* between the individual's performance and the measurement of results.
- Understandability
 - What are we held accountable for?
 - How can the measure be affected?



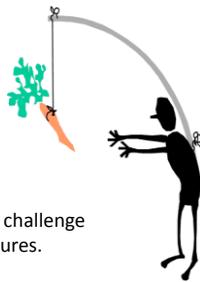
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The Reinforcements Provided

Links between results and rewards should be:

- Direct: i.e., no ambiguity or buffers;
- Definite: i.e., no excuses.



Rewards must be *relevant* - a challenge we will discuss in coming lectures.

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Always Consider the Strategic Context

The point of applying results controls is often to *loosen* control:

- Combining results control with significant *decentralization* to manage complex operations and highly competitive environments.
- Enhance managers' flexibility subject to goal achievement (e.g., return on investment).



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Tightness of Cultural Controls

- Cultural control is generally seen as a loose form of control.
- However, cultural controls are often more powerful & stable
- But cultural controls can be very constraining. Strong organizational cultures often limit people's way of "seeing the world".



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Tightness of Cultural Controls (cont.)

- Sometimes culture provides strong control; especially when it includes few deeply held and widely shared *beliefs and values*.
- Most large organizations however have weak cultures due to diversity and dispersion of people.



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Tightness of Personnel Controls

- The tightness of personnel controls depends a great deal on *the overlap between individual and organizational objectives*.
 - Selection and training !?
- Natural overlap of individual and organizational goals is unusual, but sometimes makes other forms of control less needed.



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Personnel/Cultural Control Challenges

- How to assess control effectiveness?
- There may be sub-cultures in conflict with the culture senior management promotes. This loosens control.
- How should one deal with sub-cultures? Partly contingent on strategy:
 - Large, diversified companies – sub-cultures less of a problem and may even be beneficial. Examples:
 - “Professional” organizations, such as universities and hospitals.
 - Less diversified firms with extensive interdependencies and synergies between sub-units → more important to build a strong common culture.

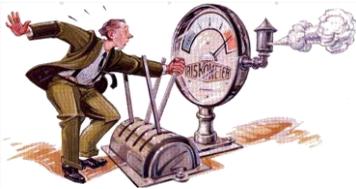


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Some Mechanisms are Complementary – Some Might be Substitutable.

Multiple tight and loose controls can co-exist be mutually supportive, but may also *conflict* with each other.

→ Adapt to situation, strategy and knowledge.

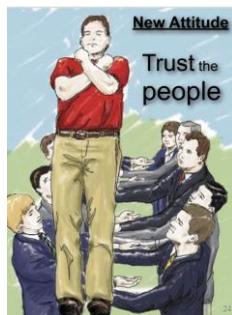


- **Warning:** Improper use of controls might have harmful side effects!

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Control can Conflict with Trust

- It's like saying: “I don't trust you”



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When is it Worth it?

Chapter 5

Kent Thorén INDEK / KTH. Builds on Merchant and Van der Stede

Recall That....

- Controls benefit is a higher probability that people will both work hard and direct their energies to serve the organization's interests.
- However, there are also costs of controls:
 - Direct out-of-pocket costs
 - Harmful side-effects

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Effectiveness of Control

Control system effectiveness depends on whether the direct and indirect costs of control are reasonable considering:

1. The (behavioral) benefits of the controls
2. The cost of not having control



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Direct Costs

For example:

- Investments in information systems.
- Managerial time spent on reporting and monitoring.
- Other administrative costs.
- Costs of rewards to make results controls and action accountability effective.



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Quantification of Direct Costs

Quantification more or less straightforward:

- *Easy* to quantify:
cost of cash bonuses, internal audit staffs, etc.
- *Difficult* to quantify:
time spend on planning and budgeting activities, on pre-action reviews, etc.

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Indirect Costs

Dysfunctional effects linked to different control systems

- Behavioral displacement
- Gamesmanship
- Operating delays
- Negative attitudes



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Behavioral Displacement

In result, action and personal/cultural control.

- Control measures that are incongruent with true objectives.
- Overquantification: measure the measurable rather than the important

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Gamemanship

(ex ante) Creation of slack as buffer to performance pressures

- Consumption of assets in excess of what is required;
- Slack can reduce manager tension and stimulate innovation;
- However, it causes inefficient resource allocation;

(ex post) Data manipulation get the targets

- Falsification of data
- Data management

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Operating Delays

Mainly a problem with action controls (pre-action reviews).

- “Bureaucracy” associated time-consuming administrative practices.
- Particularly costly where quick action is necessary – for example, stock brokers, spare parts deliveries, customer service

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Negative Attitudes

Job tension, conflict, frustration, resistance, etc.

- Are often coincident with many harmful behaviors, such as, gaming, lack of effort, absenteeism, turnover, etc.

Action controls often “annoy” professionals, but also lower-level personnel ...

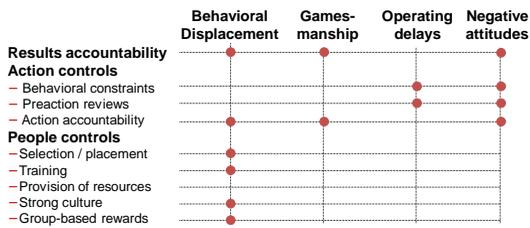
- Sometimes difficult to avoid: e.g., it is difficult for people to enjoy following a strict set of procedures for a long period of time ...

Results controls ...

- Lack of employee commitment to the performance targets;
 - targets are too difficult, not meaningful, not controllable.
 - Performance evaluations are perceived as being unfair;
 - The controls are implemented in a people-insensitive, non-supportive way.

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Summary



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Questions chapter 4 & 5

- Give and explain examples on how Sands/Bellagio could use non-financial result controls to improve business performance? Start from a identification of the key success factors (KSF) of a casino.

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Air Tex

- What control problems exist at AirTex before the take-over?



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