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.

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 people will act as the organization wishes (assuming no harmful side-effects ...).

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.
3 Drivers of Tightness

Tight control: when controls are
• detailed
• applied frequently
• low acceptance of non-compliance

Tightness is the Effect of Combined Controls

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.
Tight Action Controls (cont.)

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

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

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."
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

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."

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.
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?

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.

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).
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”.

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.

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.
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.

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!

Control can Conflict with Trust

• It's like saying: “I don't trust you”
When is it Worth it?

Chapter 5

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

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
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.

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.

Indirect Costs

Dysfunctional effects linked to different control systems
• Behavioral displacement
• Gamesmanship
• Operating delays
• Negative attitudes
Behavioral Displacement

In result, action and personnal/cultural control.

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

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

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
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.

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.
Air Tex

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