

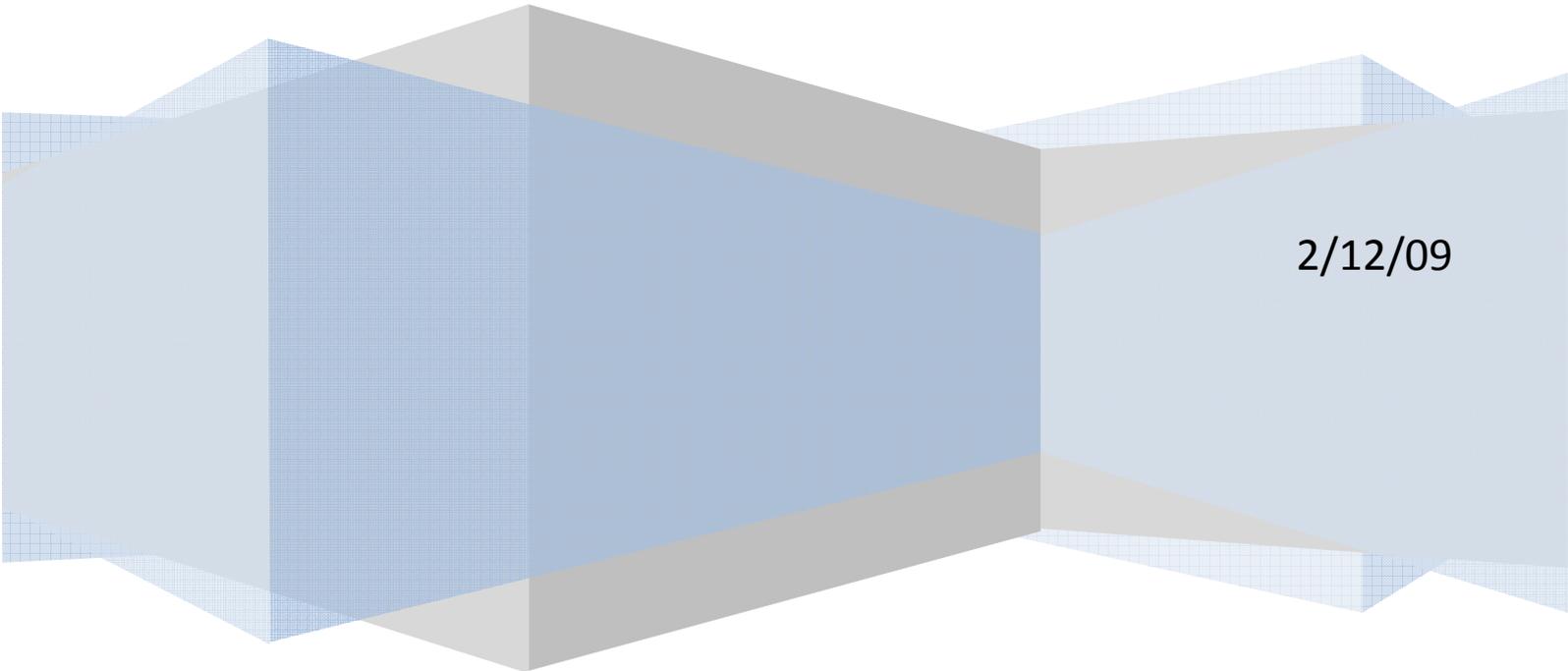
Royal institute of Technology

BEHAVIORAL MANAGEMENT CONTROL

Homework Assignment

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Question 1: How could each of the control problems at Leo's Four-Plex Theater be solved with the use of Cultural Control?

According to literature, "cultural controls are designed to encourage mutual monitoring". Shaping the culture of a company is a very hard task but there are ways to do it. The most common ways for shaping culture are *codes of conduct*, providing *group-based rewards*, *intraorganizational transfers* and *tone from the top*.¹

Code of conduct

A **code of conduct** should be developed at the theater. Even if it is the case of a small theater, that has a low number of employees, a *formal written document* would help the workers understand what is expected from them and would establish specific rules and principles to be followed. As seen in the example of *Provident Mutual Organization*², the code of conduct provides explicit behavioral guidance on different issues. One entry of the code of conduct of this company specifies that all records made in the accounting documents should be real and in accordance with the law. Bill Reilly should define such entries in the code of conduct as well to prevent the unethical behavior showed by the employees at the refreshment stand and at the ticket office.

This incentive should be supported by strong leadership figure. One of the causes for the low profit of the company is the **lack of direction** from the manager, Bill Reilly, who did not make a clear point as to what is expected from the employees.

Group rewards

A way of encouraging cultural control is providing rewards based on collective achievement.³ Even if it is a small company the theater could try to implement the **open book management** technique, which consists in sharing the financial results with all the employees and training them to understand "what the information means and how can they contribute to company performance" in such a way to increase the chances of group reward. In this way the employees of the theater would not cheat by offering free refreshments and free entries in the cinema to friends. It is very important that the employees understand how the theater works and which its sources of profit are.

Employee rotation

By **rotating employees** between the three points that present problems will help the theater prevent the frauds that have been going on. Furthermore, to improve this technique the

¹ Merchant and Van der Stede, 2007, p85-90

² Merchant and Van der Stede, 2007, p86

³ Merchant and Van der Stede, 2007, p88

manager should assign randomly each day who will perform each tasks. In this way, the employees will not be prepared and the probability of cheating will decrease.

Strong leadership

What Leo's Four-Plex Theater needs is a strong ***tone at the top***. Bill Reilly encouraged this unethical type of behavior by offering free passes authorized with his signature. If something is to change at this theater it should come from the manager itself. He should set a model of integrity to the others employees, not encourage and tolerate unethical behavior.

Question 2 What Personal and Cultural Controls do Armco use, and what Personal and Cultural Controls could they use?

Personal Controls

The definition of personal controls states that they "build on employees' natural tendencies to control and/or motivate themselves". These types of controls are used to clarify expectations by making everyone understand what the organization wants, to assure that the best qualified resources is assigned for a specific task and to make sure that the proper resources are available in order to perform those tasks.⁴

The case suggests that **personal controls** were not very efficient during **old** performance measurement system. *Resources*, also available, were overwhelming and resulted in wasted time. Managers spend time explaining everything down to the smallest expenditure instead of trying to solve the main cost problems.

Another personal control problem related to the old system is that it did not allow *self-monitoring* at lower managerial levels. All the responsibilities fall on the shoulders of the cost center managers who tried to solve the problems as they thought best.

After the introduction of the **new system** which distributed responsibility to all the employees Armco could use the following methods to try to implement personal controls:

- ***Training***: since all the jobs were reallocated and it was not the purpose of the new system to try to replace employees, Armco should use training programs to teach all employees how the new performance evaluation system works. In this way the company will increase the probability that employees perform a good job and that the new system will be successful.
- ***Job design and provision of necessary resources***: Because the new system raises the responsibility of lower level managers, this jobs should be redesigned by making everyone understand what are their responsibilities and tasks. Also, to help

⁴ Merchant and Van der Stede, 2007, p83

employees do their best, Armco should make sure that all the necessary resources, including information and staff support are available when needed.

Cultural Controls

According to the financial manager of Armco, what the company is trying to do with the new system is “to change the way managers think. The new system is not yet part of their mentality.”⁵ Therefore, Armco should use every method it can to develop the new culture.

- **Codes of conduct:** A formalized document based on the 10 key performance measures should be written to create awareness of the new direction of the company. The document should explain the *vision* of the new management process, as described in the following figure.

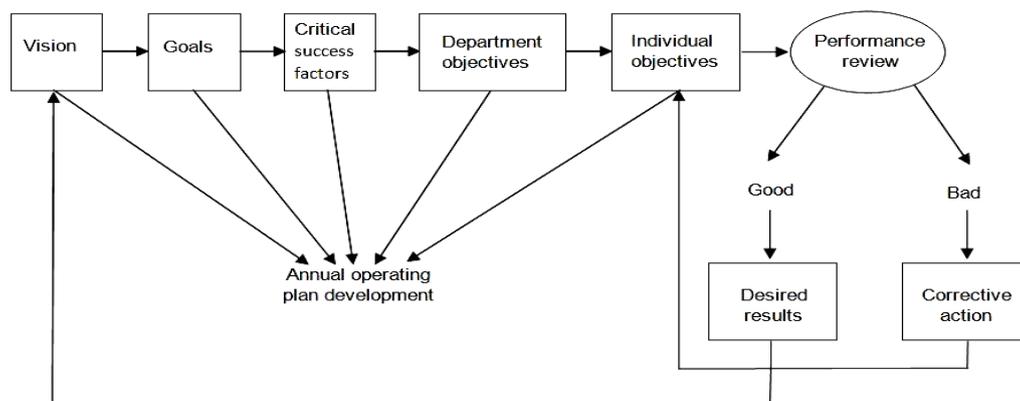


Fig1. Vision management process⁶

Codes of conduct are a very effective way to influence the direction of the company. There is no information provided in the case to whether Armco is using or not a code of conduct.

- **Group-based rewards:** To encourage a better cultural control Armco should implement reward plans based on collective achievement. This type of incentive was not used before the implementation of the new system. During that period individual cash incentives were used. Assigning people to work in group is a highly motivational measure that will help the employees at Armco adjust to the new rules.⁷
- **Intra organizational transfers:** This technique would be probably hard to implement at Armco due to job specialization.
- **Physical arrangements:** Armco could try to design the open office to facilitate communication and *flow of information* between members of specific departments.
- **Tone from the top:** As mentioned above, the company is well aware that managers are not yet comfortable with the new performance system. Therefore, efforts should be made to promote the new direction of the company. This process will be very

⁵ Merchant and Van der Stede, 2007, p37

⁶ Merchant and Van der Stede, 2007, p48

⁷ Merchant and Van der Stede, 2007, p91

challenging because as indicated in the text the managers liked the old system and felt more comfortable with it.

Question 3 Give and explain examples on how Sands/Bellagio could use non-financial result controls to improve business performance? Start from an identification of the key success factors (KSF) of a casino.

Key success factors are factors that are a necessary condition for success in a given market.⁸ Key success factors are critical areas of activity that must be performed well in order to be successful and to survive in competitive markets. Identifying KSF is a good reference for measuring the success of the business.⁹

One of the key success factors for the casino is **marketing**. The casino resort relied on marketing campaigns to attract high-end customers to different special events. Also, campaigns were used to promote the resort as a perfect spot for organizing conferences. To increase the success of the marketing team the managers of the casino could use **non-financial result controls**.

For example, if a marketing agent could bring more than 100 customers to a special entertainment show, he could gain *a ticket to attend for free* that event. Other non-financial reward could include a *week-end* offered by the company in one of the expensive hotels, *coupons* for dinner at the restaurants or the title of *“Employee of the month”*. I believe that these rewards do have *impact* and motivate the employees. Although we saw the case of the editors from Harvard Business Review that considered these type of gifts not good motivators¹⁰, I think that in the case of people working in this industry they do have *impact* and give a sense of pride and would add to the job satisfaction.

Related to the marketing area, the casino should monitor continuously the **strengths and awareness of the brand**, which is another critical factor.

Another key success factor identified at the casino is **customer satisfaction**. Relations with customers are of critical importance in this business. The case explains that if a customer complained the casino personnel had to take care immediately of that complaint disregarding the cost. The casino relies on customer return.



⁸ <http://marketing.about.com/od/marketingglossary/g/keysuccessdef.htm>

⁹ http://www.mindtools.com/pages/article/newLDR_80.htm

¹⁰ Merchant and Van der Stede, 2007, p403

Related to this issue same type of reward incentives can be used. For example, if an employee does not get any complaints from the customer he attends that means that he is doing a very good job and should receive any of the compensations mentioned above. Personnel working in demanding positions like dealers also could be rewarded by *extra vacation days*.

In the luxury leisure business another important KFS is **quality of service**. The casino used *mystery shoppers* to evaluate performance of dealers at the blackjack table. Same type of control could be used to all the other business areas of the casino: restaurant, spa etc.. The evaluators could be asked to determine outstanding performance of one employee each month. The same rewards could be given to the selected employees.



Technology is another critical factor for the casino, mostly for the nongaming and operations and administrative areas. The systems used by the casino helped enhance guest service and improved yield management across the company. Therefore, an error in the system could be

Question 4 What planning recommendations would you give to the CEO of Zumwald AG?

The *problem* that caused the dispute at Zumwald AG was caused by the performance evaluation system based on financial targets. Zumwald AG was structured on profit centers. The management was highly decentralized and each of the six divisions was able to source component from external suppliers. As a consequence, each division had in mind its own *budget targets* and was not concerned with the *overall benefit* of the company nonetheless with the profit of the other divisions.

If planning and budgeting systems were used properly such problems could be avoided. According to Merchant and Van der Stede, one of the main purposes of planning is to coordinate the different business units of a company. During the process of planning the flow of information across the organization is high, allowing all managers to have an overall perspective of the company.¹¹

Further research suggests that planning should be “an integral part of the system that creates goal congruence within organizations.” Planning is a technique “to control the

¹¹ Merchant and Van der Stede, 2007, p329

activities of groups and individuals to ensure they are in line with the desired organization outcomes.”¹²

What Zumwald AG needs is a clear *direction of the goals of the company as a whole*.

How can this be achieved?

First of all, the CEO of the company should revise some parts of the ***strategic planning***, especially the ones related to the strategy of each business unit in order to make them more aligned with the strategy of the entire company. This will help the managers understand the needs of the other business units.

Related to this issue, the company should consider alternative the *reward and compensation systems*. Until now, Zumwald was using incentives based on the financial results of each division. The performance evaluation system should include *group rewards* based on the collective results. Thus, Zumwald will encourage strong collaboration between teams and will support cultural control.

Hon skriver väldigt efter boken.

Regarding the ***capital budgeting***, the CEO should try to identify those projects that can be implemented in cooperation between the six divisions of Zumwald but also those that take advantage of the individual competitive advantage of each business unit. *Communication* is essential during this phase since the projects selected should be the ones which are most lined up with Zumwald corporate objectives and with the projects of each division.

Related to the current problem faced by Zumwald, it is mentioned in the case that the business volume related to the new product was less than 5% for the first few years. Since we are talking about the *introduction* phase of the product life cycle, the purpose of the company should be *minimizing costs*, thus allowing ISD division to outsource. If the product results to be a success, thus representing an important revenue source, Zumwald should try to find a way that will benefit all the divisions of the company.

During the ***budgeting phase***, the focus of the CEO of Zumwald should be directed towards setting the *performance targets*. According to Merchant and Van der Stede, “the use of preset performance targets in business organizations is almost universal”¹³

The performance targets should be *challenging but achievable* to stimulate the motivation of the managers so that they can focus their efforts on the task. If targets are set too high the managers will feel discouraged and will lose commitment to the target¹⁴.

At Zumwald the performance targets are probably too challenging. According to the case, this performance evaluation system was based on the financial achievement of each division for *return on invested capital (ROIC)* and *sales growth*. This is the reason why the managers

¹² Malmi and Brown, 2008, p291

¹³ Merchant and Van der Stede, 2007, p333

¹⁴ Merchant and Van der Stede, 2007, p336

could not agree one with the other. A possible solution would be to offer the rewards based on the same indicators but at corporate level, not division level.

Question 5 In what respects are the department managers at AirTex subject to tight control? In what respects are they loosely controlled? Both questions regard the situation after Frank and Ted's takeover.

The new control system implemented by Frank and Ted had elements of all control system but was based mainly on *result control and action control*. The two managers **decentralized** the operations of AirTex, creating profit centers for each activity and grouping them by departments. They enhanced the responsibilities of each department manager by giving them authority over all operations including: *granting of credit, pricing authority, purchasing to a predetermined limit, setting policies and collecting receivables*.

Because the department managers were not used to such responsibilities, Ted and Frank instituted a *Daily Department Report*. This meant that each department had to submit daily documents with all the operating and accounting information for that day.

Analysis of the control system

According to Merchant and Van der Stede "tight result controls might involve detailed and frequent budget reviews of performance and significant performance-dependent incentives"¹⁵ I will analyze the control system based on the following criteria proposed by the same authors: *definitions of desired results, performance measurement, and incentives*.

- **Definition of desired results:** In the case of AirTex, a company struggling to stay alive, the new management *did not explicitly formulate performance targets* in terms of financial results for each business unit. What Ted and Frank wanted was to make profit and save the company from going bankrupt. The only performance target mentioned in the control system structure is that a profit center should have profit. In that case the department manager was entitled to a bonus.
 - However, the managers tried to make sure that the new system was understood and applied correctly by the managers. That is why they used the Daily Department Reports. Ted and Frank were having permanent control over the activities and the financial situation of each department.
 - The direction of each department was **congruent** with the goals of the company.
 - Also, regarding the **timeliness** of the targets, Ted established monthly charges against the departmental profit if receivables were paid with a delay of more than 60 days.

¹⁵ Merchant and Van der Stede, 2007, p118

- **Performance measurements** In the management control structure defined in the case there is *no precise performance target mentioned*. Even if the Ted personally assumed the responsibility of teaching and making managers understand clearly the tasks, the control system does not have tight performance measurements.
- **Incentives:** Every profit center manager was rewarded with a bonus of 10% of the profit of their business unit. In this case there is a **direct link** between the achievement of a good performance and the reward. However, in the control system structure defined by Ted, there is **no definite link** between results and reward, which means that managers that had zero or negative profit (loss) were punished by not receiving bonuses. Therefore this factor contributes to a *loose control system*.

Overall, ***the result control system is not tight.***

Regarding the **action control**, the only information available in the case is the fact that profit center managers had a *predetermined purchase limit*. However, Ted was not checking the purchases up to the smallest amount of money. Furthermore, no other action control incentives were implemented; therefore, the action control is also loose.

In conclusion, I appreciate the control system implemented by Ted and Frank at AirTex *loose*.

Enkelt och konsist, bra!

Question 6 Evaluate the different types of rewards and punishments currently used in Tsinghua Tongfang.

Evaluation of the Reward System

The evaluation model for reward system proposed by Merchant and Van der Stede is based on the following criteria:

- **Rewards should be valued.** According to literature, “money has an important symbolic value”¹⁶. Many people consider monetary rewards as a measure of *prestige* or even *power*. Also, since most of the personnel at TT had graduate and post graduate degrees, *promotions and stock options* are also a measure of their success. Therefore, the reward system **had value** for the employees.
- **Rewards should have impact.** Besides the bonus plan, the reward system included a voting evaluation to select the top 1% “Star Employee” and the top 5% “Excellent Employee”. According to the case, these employees were eligible for *promotions, overseas study opportunities and new share issues*. These rewards have *impact* and are *visible to others*. 66% of the employees at TT have bachelor degrees and 22% have master degrees, which imply that they are ambitious persons who want professional recognition, compensation and career development.

¹⁶ Merchant and Van der Stede, 2007, p404

- **Rewards should be understandable.**
 - The *performance evaluation system* and the *stock option plan* at TT` could be evaluated as understandable. They are described with clear, objective and extensive criteria easy to understand by all employees.
 - However, the *annual employee vote* is not based on any objective criteria and therefore it might lead to confusion.
- **Rewards should be timely.** Both the monetary and non-monetary rewards are not timely.
 - *Salary increases* and *bonuses* are evaluated annually therefore, it can take up to 12 month after a successful performance for the reward to be gained
 - The rewards based on the *voting system* are even more long-term. Even if the vote takes place annually, it might take more than 12 month after the employer did something good to the moment he receives the rewards. In the case of stock options, since there is a company target that has to be achieved for stock options to be offered the employee might have to wait a very long time to be rewarded.
- **Rewards should be durable.**
 - According to a study presented in the textbook, “monetary rewards particularly small ones are not durable.” The case study present the results of a study performed in the United States that shows that employees have used the bonuses to pay bills and other common expenses. Even worse, the case shows that some of them do not even remember what they did with the money. Therefore, it can be evaluated that all monetary rewards at TT are not durable.¹⁷
 - On the other hand, the study opportunities and promotions will be remembered by the employee for a long time. It is hard to forget an abroad experience or the position you have in a company.
- **Rewards should be reversible.**
 - *Reversible rewards at TT: bonuses* which are allocated only during one period of evaluation. If the employee does not maintain the same level of performance further bonuses will not be allocated. Also, *overseas study opportunities*, can be included in the same category.
 - *Irreversible rewards at TT salary increases, promotion, stock options.* According to Merchant and Van der Stede, “salary increases provide an almost permanent annual annuity” that cannot be withdrawn easily.¹⁸
- **Rewards should be cost efficient.** Obviously, all monetary rewards are expensive and “the value provided to the employee is a direct cost to the firm”¹⁹.

¹⁷ Merchant and Van der Stede, 2007, p405

¹⁸ Merchant and Van der Stede, 2007, p405

¹⁹ Merchant and Van der Stede, 2007, p405

Evaluation of Punishment System

According to Merchant and Van der Stede in many organizations “punishments manifest themselves though an absence of positive reward.”²⁰This is the case of TT too.

The punishment system is not based on public humiliation as in the case of Black & Decker where business units manager that did not meet the financial targets were sited on the right side of the room while the one who achieved their target had to sit on the left.²¹

Maybe absence of rewards is not as powerful as having to sit on the right side of the table. In the case there is no information to whether the paychecks are or not confidential, but in most cases they are, so employees could not find out about the rewards of peers. The impact was lower.

However, as mentioned above, the employees of TT were ambitious well educated persons, eager for promotions and professional recognition. So, it can be concluded that this punishment system had a lot of *impact* on them.

Avslutar ändå med EN
sammanfattning, skönt

Question 7 Should Berkshire Industries make special adjustments for the Spirits Division? In that case: what adjustment?

The Spirits division could not reach the profit targets due to the effects of recession. During that year, the customer demand decreased significantly and to cope with the situation the market price for spirit dropped. In order to survive, the spirits division had to cut the price for their products too.

Recession is an **uncontrollable factor** that cannot be influenced by the managers and the employees of the business unit. The CEO of Berkshire is facing a similar situation with the one described in the Chuang Ye case: unsatisfied, unmotivated managers who do a good job but cannot reach target due to factors they cannot control.²²

In my opinion, in times of recession it is necessary to *adjust*. There are several reasons for this.

- First, as mentioned above, recession is an **uncontrollable factor**
- Second, the predetermined **targets are not realistic**. In the current market situation they could never be reached by anyone.
- Third, managers will **lose motivation** and they might quit the job.
- Finally, the results of the Spirits Division **affect the whole organization**.

²⁰ Merchant and Van der Stede, 2007, p393

²¹ Merchant and Van der Stede, 2007, p393

²² Merchant and Van der Stede, 2007, p573

In class we have seen cases of other companies that also adjust their performance evaluation measures in case of uncontrollable events. It has to be observed that the cases presented in class, *Olympic Car Wash* and *Formosa Plastic Group* had subjective performance evaluation systems, so the adjustment might be easier in this case.²³

In the case of Berkshire, the decision of the CEO has to be explained in formal documents, such as **contingency plans**, that describe exactly what happened, what the consequences are and why the monetary rewards changed.

What Berkshire should do is hire an **audit team** to have an external point of view on how to cope with the fluctuating market demand. What I think happened in the case of the spirits division is that managers worked so hard to achieve the unrealistic target that they forget to look for solutions how to get out of this situation. This problem of focusing on short-term results, rather than looking at the problem on the long term is also known as **myopia**. An external experienced team which has already dealt with these types of problems could offer a viable solution.

Regarding the bonuses offered to managers, those are based on **economic profit**. Since the economic crisis affects all the divisions of the organization in one way or another, the manager should try lower the bonuses to the point of not offering them at all, so that the managers of the worst affected division be rewarded for their hard work. If this is not the case, managers might quit the company, which would leave Berkshire in an even worse situation. Having to train new people in a time of crisis, to make them understand what they have to do it will be even more costly than keeping the current managers.

Question 8 How can audits be used to deal with uncontrollable factors?

The definition given by Merchant and Van de Stede for **audit** is “a systematic process of objectively obtaining and evaluating evidence regarding objects of importance, judging the degree of correspondence between those objects and certain criteria and communicating the results to interested users.”²⁴

The same authors categorize uncontrollable factors into the following three areas

- Economic and competitive factors that affect among other things profit. Such factors are changing customer demand, changing laws and regulations and foreign exchange rates.
- Acts of nature such as hurricanes, earthquakes, floods, terrorist attacks, or thefts.
- Interdependencies inside organization.

²³ Håkan Kullven, 2009

²⁴ Merchant and Van der Stede, 2007, p638

In order to answer the question I will focus my discussion on how audits can be used to cope with the **volatility of customer demand**. In this purpose I will use the *case of Lucent Technologies*, described by Moon, Mentzer and Thomas, analyzing how the company used audits to solve forecasting problems. Then I will discuss a new audit methodology developed by Salama, Luzzatto, Sianesi and Towill.

Lucent Case²⁵

Lucent, one of the leading global suppliers of data networking systems, has realized that customer demand forecasts were extremely inaccurate. To help deal with the situation the company hired a *team of experienced auditors* to try to solve the problem.

The reasons why Lucent performed this audit to solve the forecasting problem is the same why any company should use:

- 1) An audit is performed by **persons outside the company**. Therefore, the persons involved in forecasting were opened in reporting their problems. This could be extended to any type of uncontrollable factors listed above. The problem is not that internal employees are not capable to resolve the problem, but they are too focused on short-term targets, especially financial ones, that they become **myopic**.
- 2) An audit team brings with it all the accumulated **experience**. Thus, they can see problems from other angles different from the ones of the managers of a company.

The phase of obtaining and evaluating information is a lengthy one. In the case of Lucent lasted more than one month due to the complexity of the company. This process was **objective**, because Lucent hired *external auditors*. This should be the case of any company that wants to undergo such processes, due to the fact that internal auditors could bias the information.

The findings of the audit firm in the case of Lucent were divided into *different areas*. One of them was the fact what they called "*islands of analysis*".²⁶ What might happen in a company that goes through unexpected events is that communication is not well transferred between departments. Managers try to focus their attention on escaping the situation, ignoring the opinion and findings of others. Therefore, an audit team which analyses the situation exhaustively will offer a better solution to the problem.

The **value** of the audits comes mainly from the credibility of the information offered. As I have seen in the case of Lucent, the audit team had 30 years of experience, thus the company implemented the proposal without reservation.

Much research has been dedicated to the topic of auditing. One interesting study is "The value of auditing supply chains" in which the authors present a new methodology for

²⁵ Moon, Mentzer, Thomas, 2000

²⁶ Moon, Mentzer, Thomas, 2000, p22

auditory of the supply chain that I think can be successfully applied when dealing with unforeseen situations. The methodology consists of three stages:²⁷

- **The diagnostic stage.** During this stage extensive study of the interactions that take place in an organization (between people, processes and technology) is performed. The outcome of this phase is a list of possible solutions for the problems that the auditory team investigates.
- **The priorities stage.** The phase consists in analyzing the solutions based on effort-benefit analysis and prioritizing the list on the basis of “least effort compared with most benefit”
- **The value stage** The selected solution is analyzed economically, the process ending with the calculation of the net present value.

Dealing with uncontrollable factors is a challenging task, especially for a person that working inside the company facing the problems. As suggested in the article “The value of auditing supply chains”, sometimes problems are not solved because the company fails to identify them”. A competent audit team will offer a contingency plan to deal with uncontrollable events.

Question 9 In what ways can what happened at Lernout & Hauspie be considered ethical?

Ethical models consider that in a social context ethics concerns the analysis of how “actions affect the interests of other people”.²⁸ To discuss the Lernout & Hauspie case I will analyze the actions according to the ethical model studied in class: virtue, consequentialism and deontology.²⁹

Virtue

Examples of virtue include integrity, loyalty and courage.³⁰ In the case of L&H the following activities could be regarded as *ethical* according to this model:

- The two entrepreneurs Mr. Hauspie and Mr. Lernout, showed **courage** when they decided to start such an ambitious project.
- Courage and integrity were demonstrated also by the John Duerden, the new manager of L&H when he ordered an investigation by ProcewaterhouseCoopers and made the results of the investigation public.

²⁷ Salama, Luzzatto, Sianesi, Towill, 2009

²⁸ Merchant and Van der Stede, 2007, p687

²⁹ Håkan Kullvén, 2009, class notes

³⁰ Merchant and Van der Stede, 2007, p689

Consequentialism – Utilitarianism

According to the utilitarianism theory, “the rightness of actions is judged solely on the basis of their consequences.” The model suggests that an action can be considered moral if “it maximizes the total of good in the world”.³¹

From this perspective, we can characterize the actions of including fictitious sales to increase profit as a way increase the revenues of the stakeholders. Serving the benefits of the stakeholders can be considered as ethical. Also, by entering the European technology elite, the company was increasing the prestige of Belgium, which is presented as a very pride nation. So, the consequences of their action benefited a *great amount of people*.

Deontology

From the perspective of deontology actions are analyzed as being ethical or not by looking at the specific act, not at the consequences as in the case of consequentialism.³²

Unfortunately, it is the actions taken by the company of *creating fictitious clients* and of *lying in accounting documents* that led to the massive *fraud*.

The only action that is ethical, is the one taken by the last manager of L&H: ordering the investigation by PwC.

³¹ Merchant and Van der Stede, 2007, p687

³² http://en.wikipedia.org/wiki/Deontological_ethics

Case Analysis

Question 1 Was AirTex in a need for a new control system? Why/why not?

AirTex was in need of a new control system. I will discuss the causes of the need for a new control system by assessing the **control problems** present at AirTex before Frank's and Ted's takeover.

Lack of direction

The president of the company, Bill Dickerson was frequently absent from the company, leaving the company in the unskilled hands of the accountant, Sarah Arthur.

Motivational problems

Several motivational problems can be identified at AirTex:

- In the Avionics department, the manager demonstrated **effort aversion**. Leon Praxis was leaving the job at 5 sharp to attend other personal interests.
- In the flight training department employees were **resistant to change** in every aspect: technological, new flight methodologies or new accounting systems.

Personal limitation

- The first example of personal limitation can be identified in the case of Sarah Arthur, the person who took all responsibility for the management. Although enthusiastic and committed to the company *she lacked training and managerial skills*. Also, she was responsible for keeping information to herself and not sharing the situation with the department managers
- As a consequence, the department managers knew nothing about the profitability of their operations. They *lacked all existing information* in regard to what they were doing.
- Another example of personal limitation is the lack of formal education of department managers.

After the takeover, AirTex can be described as a **changing organization**.³³ Ted and Frank the new managers wanted to restructure the whole organization by creating profit centers, authorizing department managers to take decisions and installing a new accounting system. They wanted to create an environment where the departmental managers could make correct decision by themselves.

³³ Chenhall and Euske, 2007

According to literature, in the case of an organization that is undergoing change *the role of a management control system is very important*. A strong MCS enables interaction between central and operational sub-units and permits integrating change across the organization because it can be used “to deliver information down to operating managers to enable them to take more effective decisions”. Since Ted and Frank have decentralized all the activities, a new MCS was the only way to *monitor* the financial activities of the decentralized departments. Also, the MCS provides a good way to stay in touch between department management and top management, so that the long-term goals of that are related with the change are successfully implemented.³⁴

Also, “effective change involves employee commitment”. A MSC facilitates the communication and the development of a culture in the organization and provides a “*unifying language and way of thinking*”.³⁵ AirTex needed a *common language*, understood by all the people involved in the company.

Question 2 Evaluate how the new control system at AirTex takes use of elements of results control, action control, cultural control, personal control.

Elements of results control

The new control system introduced by Ted and Frank included the following elements of results control:

- The control system was based on **decentralization** and given **authority** to profit center managers
- **Performance dimension**. As discussed in question 5, due to the looseness of the new control system performance dimensions were not clearly defined. The company was trying to *make profit* to save itself.
- **Measurement of performance**. As typically in the case of results control the measurement of performance was financial. In the situation of AirTex this made even more sense due to the financial crisis faced by the company.
- **Performance targets** were not fixed tightly. In the structure of the control system elaborated by Ted there were no fixed financial targets mentioned.
- **Rewards** used in the case of AirTex consisted in bonuses of 10% of the department profit.

³⁴ Chenhall and Euske, 2007, p605

³⁵ Chenhall and Euske, 2007, p605-607

Elements of action control

The only action control elements used in the new system were *preaction reviews*. There was a purchase limit fixed for each department.

Elements of cultural control

Ted and Frank tried to create a strong culture in the organization by giving a strong **tone from the top**. They wanted to make everyone understand that things have changed and now they are responsible for their actions and wanted to show the direction of the company.

Elements of personal control

Regarding the personal control, the new system used informal **training**. Ted took the role of teacher for the unskilled department managers. In order to do this he installed a blackboard and arranged his office as a small classroom where he could discuss the questions of the managers.

The new control system was based on enhanced responsibilities for the department managers. They had to make decisions by themselves and they were responsible for all the cash of their department. For this to work, proper measures regarding the **provision of necessary resources** had to be taken. Ted made sure that all accounting documents, accounts payable and receivable were available for the use of department managers.

Personal Statement

During the course I read the cases and the chapter before class. This helped me understand better the class discussions and the topic presented in class. Also, it was helpful for the homework assignment too, as I was already familiar with the topics and the cases.

Working for the seminar was very interesting too. The work was divided between all group members and we usually met on week-end to put together the information.

Regarding the research I did for this course, I would like to point out that I was interested in the topic of fluctuating customer demand because my master thesis will be based on this and supply chain management and therefore I wanted to see a perspective of how to deal with these topics from the control system point of view.

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