

KTH

Homework assignment

ME2028 Behavioral Management Control

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09

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

Cultural control is a type of control that encourages mutual monitoring¹ and it builds a lot upon group pressure. The main idea of cultural control is to get the employees to watch over each other and to create a culture that has certain things that you specifically do or don't do. It aims to set up shared *beliefs* and *norms* in that company, rules of behaving that everyone abides by.

The case of Leo's Four-Plex Theater has a number of control problems that I can identify. They are as follows:

- Discrepancies in the cash counts of the ticket booths. Most likely caused by a *lack of motivation* that leads to employee theft and neglecting of duties.
- The employees working in the refreshment stand sometimes do not collect cash from customers or doesn't register the sale on the cash register. This is also most likely caused by a *lack of motivation*, it can't be lack of direction since they know what they should do and neither could it be a personal limitation since they know how to operate the machine and how to collect payment. The problem seems to be that they don't know *why* they should collect the cash.
- Test counts reveal that the number of tickets sold or put into the stub box isn't equal to the amount of customers entering and leaving the theater. This seemed to be caused by three factors:
 - The attendants at the turnstile aren't checking the tickets carefully enough since tickets with wrong dates and colors go into the wrong stub boxes. Most likely caused by a *lack of motivation*, the employees aren't motivated to check the tickets carefully.
 - Bill Reilly, the manager, gives out a significant number of free tickets with his signature on them. Could be caused by a *lack of motivation* he isn't motivated to not give out a lot of free tickets, or a *lack of direction* no one has told him that he shouldn't give out too many free tickets.
 - Attendants give free passage to their friends who hasn't purchased tickets. This is likely caused by a *lack of motivation*, they don't have any good enough reason in their opinion as to why they shouldn't let their friends in.

The above problems could all be solved with cultural control. All that really should suffice is a few simple steps. The first step is to create *codes of conduct* for the theater. They need to state rules of behavior and attitude in an official document, e.g. that you should always collect payment from customers and always register it in the sales register; and also that you aren't allowed to put money into your own pocket, without calling the employees thieves, of course. These rules should also be clearly motivated as to why they are to be heeded. To make sure that we get the wanted effects of the codes of conduct it is also important that the

¹ *Management Control Systems*, 2nd edition, page 85, Merchant and Van der Stede, 2007

employees get to influence and discuss these². Time should therefore be spent on formal discussion sessions with the employees to make sure that everyone takes the codes seriously.

The second step is to get Bill Reilly to set a good example and not give out too many free tickets. The *tone from the top*³ should be consequent. It should suffice to just talk to Bill and explain that the company doesn't benefit from him giving out too many free tickets.

As a last step we need something to motivate the employees aside from the codes of conduct. Rewards like a bonus that is granted when there are no discrepancies in the cash count could be used. Punishments could also be used, e.g. the missing amount of cash each month gets taken from the employees' paychecks.

Regarding cultural control, I took notice of a problem with it during last summer when I worked in a Swedish telecom company. They had a very strong culture and everyone was told to always follow the company values, which were printed on posters hanging on the walls of most offices. If you faced a situation where you had to make a decision and asked a manager for advice you would most often get told to follow the values, which sometimes didn't help at all. My conclusion is that cultural control may sometimes not be sufficient to solve some *lack of direction* problems, since it's very loosely defined and doesn't give a clear course of action. However, with the use of the above steps the problems could be solved with a high probability.

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

While cultural control is used to create a certain culture and mutual monitoring, personal control is used to control who the organization works with and what *resources* the organization allocates to employees. When using personal control you want to *empower* employees and encourage *self-monitoring*. According to our course literature there are three major methods of implementing personal control⁴:

- Selection and placement – Making sure that we get the *right person for the right job*
- Training – Improving employee *skills* and sense of *what the company expects of them*
- Job design and resources – Making sure that employees get the right *resources* and a *chance to succeed*

There weren't many clear evidences of personal or cultural control in the Armco case. The one thing I could find was:

- In the new system the company limited the amount of information reported to each manager. It was thought that manager would get more focus on relevant figures instead of just getting a huge amount of accounting numbers. This is a

² *Management Control Systems*, 2nd edition, page 86, Merchant and Van der Stede, 2007

³ *Management Control Systems*, 2nd edition, page 88, Merchant and Van der Stede, 2007

⁴ *Management Control Systems*, 2nd edition, page 83-85, Merchant and Van der Stede, 2007

form of *personal control* that falls into the category of the third point in the above list.

Unfortunately, the personal control above failed due to manager dissatisfaction with the new system. The company thought that by reducing the amount of information that managers receive, they could easier see the relevant number and enable them to spend less time on analyzing figures and more time fixing problems. However, it didn't succeed, according to my own theory that the managers' *perceived level of control* lessened. In other words, in their perspective they didn't get the amount of information necessary to control their business, so instead of feeling *empowered* they felt the opposite. To explain this with the theory from course literature, the *controllability* wasn't that good because the managers' *understandability* for the new numbers was insufficient. Because managers had grown used to the old system, *understandability* was higher for that system.

The new system isn't bad; the managers just prefer the old one because they have grown used to it. One form of personal control that could minimize manager dissatisfaction is *training*. Teach the managers how to use and analyze the new numbers they get and they will accept it more easily. Also, cultural control could be used. If you try to integrate the new system into Armco's culture, it would be easier to implement than by just giving managers a new set of numbers. *Discussion sessions* and creating *company values* that state that you should always be open to change, these things would help to get a more accepting culture. However, perhaps it is the other way around, when the new system is accepted, then it is integrated into the culture.

Finally I would like to add two things. First, the plant I huge and employees have long distances between different sections. A good idea would be to implement the form of personal control in point three above, giving employees the right resources. By moving the sections closer to each other communications would be easier. Second, the employees should not be held responsible for uncontrollable events like power failures. That is a bad form of personal control. Like it was stated above, employees should be given the chance to succeed, something that is near to impossible for Gary Downey in the case⁵.

3. 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.

I have identified several *key success factors* for the Bellagio casino.

The casino has chosen to have a high standard profile, therefore the KSF *quality* is critical to their business, if they don't have quality they aren't true to their standards and they won't live up to customer expectations. According to me, a casino builds on three principles; that it attracts enough customers to be profitable; that it generates a satisfactory amount of money

⁵ *Management Control Systems*, 2nd edition, page 42, Merchant and Van der Stede, 2007

from each customer; and that it has sufficient security to handle the huge amount of money without losses.

These three principles can be translated into KSF:

- Efficient marketing – To attract customers
- Customer relations – To keep customers and maintain good relations with the profitable high-end gamblers
- Security – To minimize theft and cheating both from employees and external sources
- Employee experience – To minimize both cheating and to increase the amount of money earned from each customer

Now from these I will start to give examples of result control that the Bellagio can use to improve business performance. According to the course literature there are three conditions that should be present to maximize result control effect⁶:

- Knowledge of desired results – What results do we want?
- Ability to influence desired results – Can employees influence results?
- Measuring results effectively – How good can we measure the results?
 - Precision – How large is the random factor?
 - Objectivity – Is the free from bias?
 - Timeliness – How fast can we get the measurements reports?
 - Understandability – Do the employees understand how they are measured and how they can influence it?

First, the simplest way to measure quality would be to start using customer polls. Since it is the customers who the company aims to provide high quality to, it is they who are most eligible to rate the quality. The polls should then be converted into numbers, measuring customer satisfaction. This way of measuring is not perfect in *precision* since it build upon a random selection of customers. The lack in precision can be minimized through designing a good polling system. It is not free from bias; since employees may try to persuade customers to rate them higher than they deserve, or even bribe customers. The timeliness is good, there is a small lag between when customers get served and when employees get the report. Regular reports should minimize timeliness issues. The understandability is good, employees can easily grasp what is being measured and they know that to influence they can just give the customers better service. Almost all employees at the Bellagio could be subject to this measurement.

Other interesting things for the Bellagio to measure and use in results control would be; games played per day (dealer measure of efficiency and experience), increase in new customers (marketing measure of marketing effects), number of complaints (measure of customer satisfaction), percentage of cheats and thefts caught (measure of security). I will not discuss these measurements in detail since I don't want to make this question too long.

⁶ *Management Control Systems*, 2nd edition, page 32, Merchant and Van der Stede, 2007

However, these measurements are all fairly precise, objective, timely and understandable. I think that the Bellagio should reward good results and have severe punishments for failure to perform good enough; a system with tight control can't afford to be lenient with unwanted behavior.

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

I'm going to present how I think that the CEO of Zumwald could use planning to try to avoid problems like the one in the case.

Planning is something that takes place in every company, at least I haven't heard of a company not using planning at all. According to the course literature planning is made for the purposes of *planning, coordination, top management oversight and motivation*⁷. The book also says that it is the planning process that is what companies benefit the most from and not from the actual results of the planning. That is especially true for the solution to Zumwald's problem, I believe. In this case, what targets the company sets and the fine details isn't interesting. I will deal with how the company would benefit from the planning *process*.

The problem in Zumwald is that there is a lack of communication between the divisions. The company is decentralized, but the amount of independence seems to be creating conflicts instead of stimulating creativity and entrepreneurship. In this case the problem was brought to attention very late.

This could be solved by using the benefits of planning, especially the purposes of *planning* and *coordinating*. Communication between divisions can be improved with by implementing inter-divisional planning. The divisions need to communicate to each other what they plan in the future, if they do cases like this will more likely be avoided. For example, if Heidelberg was aware of ISD's plans they would have longer time to talk with ISD, consider if the affair was worth taking and positioning the division to be able to get the contract. Obviously, the company would also gain the advantage of using *preaction*. By using inter-divisional planning the company can faster be made aware of situations like the one in the case and act to solve them before they appear or in the early stages. Then the CEO wouldn't be notified of the problem as late as in the case.

Also, it would perhaps be beneficial to appoint a special group of experienced individuals to participate in the act of planning. Acting as advisors, they could work to lessen conflicts and try to work out what's best for the company. That would certify that the good of the company was never compromised and it would reduce *sub-optimization*.

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.

After Ted and Frank's takeover, AirTex was changed radically. Some relevant control systems that were put into use were:

⁷ *Management Control Systems*, 2nd edition, page 329-330, Merchant and Van der Stede, 2007

- Profit centers with responsible managers
- Decentralization – Managers had more freedom in managing their respective departments
- Accounts receivable managed by department managers and they were charged for an aging factor of their receivables
- The administration profit center – Took care of administrative costs and charged the departments. Also handles loans
- The Daily Department Report – Forces managers to keep track of their business, giving them awareness of their operations

Tightness in management control systems increases the chance that employees will behave and produce results according to what the organization desires. I will focus on tightness by *action control* and tightness by *result control*, since they are the most relevant to this case, according to me. Result control can be made tighter by defining desired results correctly, measuring results effectively (see the conditions for result control in Question 3), and by providing the right incentives. Action control can be made tighter by using physical or administrative behavioral constraints, frequent preaction reviews, and by making employees accountable for their actions⁸.

Now, to analyze the case. The managers, in the new decentralized AirTex, are free to manage their departments very freely. The *direct action control* in how the departments are managed is loose, they have few constraints, however the *result control* is tighter. How the managers control their departments is controlled by the responsibility for *profit centers*. No *targets* for the profit centers are stated in the case, however, managers get bonuses of the profits made by their profit center. Since there are no targets the control can't be called tight, but it is not inefficient since managers are motivated to increase their profits.

What really indirectly controls how the managers do their work is the *daily department reports* (DDRs). It is a form of action control that forces the managers to continuously keep track of how their department is performing. It enables the managers to get *feedback* from the system itself about how well they are doing and the managers learn by doing. The control is tight, the reports are very *timely*, and the measures measure the relevant figures of the departments. There is both result control and action control mixed in this, I would say. The system forces managers to produce reports, and by producing the reports they learn about their departments. Also, the results can be used by the managers to measure their own performance. I would call this a tight reaction control system, since it gives fast feedback and chances to correct mistakes early.

The company also implements two other forms of action control. The managers gain control of their receivables. This is action accountability control. The managers are responsible for collecting money and if they don't they will get less profit due to the aging factor. That control is tight; it is congruent, the company wants to get their money fast; it offers punishment for collecting late, understandability and controllability are high for the managers. The other

⁸ *Management Control Systems*, 2nd edition, page 118-125, Merchant and Van der Stede, 2007

form of action control is the administration profit center. It is a form of administrative behavioral constraint, aims to take away responsibility for borrowing and such from managers to one unit that can handle it better.

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

These were the different *rewards* and *punishments* that I found:

- Each employee has shares in the company (reward)
- Subsidiary companies would have to finance themselves if they generated negative cash flows six months in a row (punishment)
- Salary increases and not getting an increase (reward and punishment)
- Discretionary bonus (reward)
- Performance-dependent bonus (reward)
- Star- and Excellent employee nominations
- Bonuses, promotions, study opportunities, share issues for the above the above employees

There are many kinds of rewards and punishments that a company can use. These can be divided into different categories, like *nonmonetary* and *monetary*, *short-term* and *long-term*. Rewards can be evaluated with a few criteria; *value*, *impact*, *understandability*, *timeliness*, *durability*, *reversibility*, and *cost efficiency*⁹.

You could call the fact that every employee has shares in the company an indirect reward. If the company goes well, the employees will benefit from it in the *long-term*. However, low-level employees don't have many stocks and therefore don't gain much from increases in the stock, in other words, the *impact* isn't high. *Controllability* isn't high for employees either, making it more like a symbolic reward for all but those with a larger portion of company shares.

According to our course literature, there has been an increase in the usage of *group rewards* in companies¹⁰. The group punishment used in this case isn't a good form, though. That subsidiary companies will have to finance themselves after six months of negative cash flow is a punishment that affects all of the subsidiary company. Even though that the negative results most probably are caused by bad management or uncontrollable factors. Employees can perform excellently, but still lose their job due to bad management.

Salary increases are small and monetary. One positive thing is the long-term payoff of salary increases, to really reap the benefits of a salary increase you have to stay a long time with the company. This could increase employee loyalty. However, salary increases are often occurring, and something that almost everyone gets. The punishment of not getting a raise is

⁹ *Management Control Systems*, 2nd edition, page 403-405, Merchant and Van der Stede, 2007

¹⁰ *Management Control Systems*, 2nd edition, page 405, Merchant and Van der Stede, 2007

may be more relevant than getting a raise. It may not affect the employees' economic situation much, but it is a clear signal that the company isn't satisfied. A CEO that I recently interviewed in a leadership course used this method on employees that he felt didn't fit in the company to signal that they shouldn't work there anymore.

The discretionary bonus is a bonus that is taken for granted in the case. This makes its effectiveness as a reward to lessen. If you always get the bonus and don't have to work hard to get it, the reward doesn't really motivate employees to perform better. This reward may be the least efficient one in the company. Since it's really easy to get most employees who are eligible for the bonus may just see it as part of their salary. The *impact* isn't that great since they take it for granted. *Understandability* should be low, too. If they almost always get the reward, regardless if they are performing well or less than well, the employees don't really know what kind of behavior that is encouraged. So they can't understand what they have done to get the reward, they just get it.

The performance-dependent bonus is a classical *monetary reward*. The largest rewards in Tsinghua are monetary rewards. The course literature lists a few advantages of monetary rewards, e.g. most people *value* money highly, money is a symbol of success, money isn't *durable*, monetary rewards aren't very *cost efficient*¹¹. According to the book, monetary rewards aren't timely, they often occur once a year. However, we must take the long-term into account, if we reward employees for very short-term performance, how will they then focus on the long-term?

Nominations of star- and excellent employees are rewards that are non-monetary. These employees get many benefits in the form of rewards like promotions and bonuses. The rewards are good, there are a lot of different rewards you can get, so the chance that employees *value* some of them is high. Just being officially recognized as a good employee is a reward in itself for many people. It gives them better esteem and probably a sense of belonging, which is something people need according to Maslow's famous hierarchy of needs¹². The rewards aren't timely, hard to reverse and durability lasts until the next round of nominations, however it could be longer if employees get a certificate or something similar.

To summarize, the company has many good rewards and punishments. However, the discretionary bonus isn't efficient and managers don't get any rewards but monetary rewards. Also, there is no focus on the long-term, which is why the company wants to start with stock options. That is a good decision that will add the long-term perspective to their reward system.

¹¹ *Management Control Systems*, 2nd edition, page 404-405, Merchant and Van der Stede, 2007

¹² <http://honolulu.hawaii.edu/intranet/committees/FacDevCom/guidebk/teachtip/maslow.htm>

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

In question three I presented the three conditions for effective results control. One of the conditions there is *controllability*. For results control to be effective employees must be able to affect the results to a large extent¹³. In this case we have a major uncontrollable factor, in the form of a strong drop in market demand, which affects the measured results considerably. I will quote from the book:

“Managers cannot be relieved of their responsibility to respond to relevant environmental factors, but if these factors are difficult to separate from the results measures, results controls do not provide good information either for evaluating performance or for motivating good behaviors”

- *Management Control Systems, 2nd edition, page 33, Merchant and Van der Stede, 2007*

This is exactly the case in this company. The drop in demand creates such negative margins that regardless how good managers perform, they will still get bad results. The system may be designed to auto-adjust for performance drops when setting next year's targets, however there responsiveness in the system is slow compared to the sharpness of the drop. The system is not designed to handle sharp market drops, there is a lag in responsiveness. So, the behavior of managers isn't controlled efficiently with this system. Adding to that, the bad results generated in this period of market drop will have a long-term effect on the managers' economic situation, due to negative balances on their bank accounts.

Because of the above negative factors, I think that Berkshire should make special adjustments for the Spirits Division. There are several ways that the company could use to make adjustments for the Spirits Division. It could make subjective performance targets or evaluations. However, it would be better if there was a more objective way. They could make changes in the calculations of next year's targets or discard their new system and instead use *planning* to set the targets. These methods aren't preferred either, the calculations can't be adjusted perfectly and it hurts to discard a new system that the company has invested a lot of money in.

One method that would have good chances of success is *benchmarking*. To compare the divisions results with the market average or the best-in-market would take the drop in demand into account, since the competitors are affected by it, too. This is a form of *relative performance evaluation*, it is a method used to protect employees from the effects like these¹⁴. They are all facing the same business conditions and the regulations in the spirits market are the same for all companies. So, the company should allow special adjustment in the form of benchmarking performance evaluation.

¹³ *Management Control Systems, 2nd edition, page 33, Merchant and Van der Stede, 2007*

¹⁴ *Management Control Systems, 2nd edition, page 542, Merchant and Van der Stede, 2007*

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

According to course literature there are three types of uncontrollable factors; *economic and competitive factors*, *acts of nature*, and *interdependencies*¹⁵. Audits are processes that assess certain *objects of importance* in a company and they produce a report to interest holders¹⁶. In short, audits are a way to get unbiased information about different aspects of a company. There are many forms of audits; *external and internal audits*; and *financial, compliance and performance audits*¹⁷.

One of the main factors that audits can handle but management control systems can't is top management corruption and fraud. Since the top management usually controls the control system, they can't be controlled by it. *Financial and compliance audits* can control that top management are behaving in a way that is beneficial to the stakeholders of the company. An auditor's view is reliable since they don't have, or shouldn't have, any financial or emotional ties with the company that could affect their judgment.

What audits do is to add a more objective perspective to the company. This can serve to lessen the effects of all three categories of *uncontrollable factors*. When facing a decision regarding whether the company should forgive a manager for a negative result produced partly by bad luck, the company may have an amount of subjectivity in their assessment of whether it could have been avoided by the manager or not. An audit investigation can add more *objectivity* to that decision and make it easier. When I worked in technical support at a Swedish telecom company, they were very clear that if you did something that was against the rules, internal audit would investigate. That proves that some companies strive for objective assessments at even such a low level of the company.

One uncontrollable factor that could be dealt with by audits is *stock price fluctuations and reputation fluctuations due to rumors*. The course literature states that one of the values of audits is that it *adds credibility to the information provided to user groups*¹⁸. In the case of Lernout & Hauspie, the company used audits to attempt to quiet down rumors about fraud and financial manipulation. Of course, a second round of audit discovered the fraud. However, the lesson to be learned is that audits can reduce the amount of false information on the market by getting credibility from an external and objective auditing firm. This should reduce fluctuations in stock price and reputation due to rumors.

¹⁵ *Management Control Systems*, 2nd edition, page 535, Merchant and Van der Stede, 2007

¹⁶ *Management Control Systems*, 2nd edition, page 635, Merchant and Van der Stede, 2007

¹⁷ *Management Control Systems*, 2nd edition, page 637-638, Merchant and Van der Stede, 2007

¹⁸ *Management Control Systems*, 2nd edition, page 638, Merchant and Van der Stede, 2007

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

The course literature talks about four common ethical models; *utilitarianism*, *rights and duties*, *justice* and *virtues*¹⁹. For this question, I don't consider justice and virtues. The actions of the managers aren't fair, they get a substantial amount of money for not really producing much. Also, they have no *integrity*, they don't live by the company's and their officially stated ideals and they aren't honest since they are deceiving a lot of people. So, I rule out virtues and justice.

Let's start with analyzing the case from perspective of *utilitarianism*. Utilitarianism judges actions based only on the consequences produced. As long as the *net good* in the world increases by the taken action, it is ethically sound²⁰. The philosophy could be described with the English proverb "*the ends justify the means*". We can look at the AirTex case as an example. The new managers got rid of Sarah Arthur, the woman who had previously been in charge. For all we know, Sarah Arthur could have been placed in economic troubles because of not keeping her job. It may even have destroyed her career. I'm just speculating, but the important thing is that even though Sarah Arthur could have faced some kind of crisis due to the loss of her job, the action to get rid of her is still good ethics, according to utilitarianism. The consequences for her may have been bad, but there were many more good consequences that came out of it, the company produced better results and started recuperating, among other things. So, the *net good* in the world increased, therefore it was morally good.

To apply this theory to the Lernout & Hauspie case we have to look at the consequences of the case. The company spent a lot of time on manipulation to increase their results figures. The consequences of this manipulation were very good for many people, managers got large bonuses, shareholders got very good returns on their money due to an increasing stock price and the owners increased the value of their company by a large factor. The apparent growth of the company should have produced job opportunities, too. Of course, some people didn't benefit from the fraud, customers who were hoping for a good system got a lower quality than expected and the company's financiers didn't really get much substantial value out of the company, it was all built on manipulation and numbers. So, you could say that the actions of the company were ethical, because the good consequences can be seen to outweigh the bad consequences.

Another theory a little bit similar to utilitarianism is *ethical egoism*. Ethical egoism states that you act ethically right if you always strive for maximized self-gain²¹. Since the managers in this case have acted to increase their own gains, I will assume that they haven't been doing illegal manipulation for the good of society, you could say that it is ethically correct, according to ethical egoism.

The last of the common ethical models that I haven't used yet is *rights and duties*. As a human we have certain rights determined by society. It isn't ethical to interfere with a person's rights. Take the declaration of human rights as an example²². The company doesn't violate any of these rights for any of its stakeholder. In that perspective, what happened at Lernout & Hauspie was ethical according to rights and duties ethics.

¹⁹ *Management Control Systems*, 2nd edition, page 687, Merchant and Van der Stede, 2007

²⁰ *Management Control Systems*, 2nd edition, page 687-688, Merchant and Van der Stede, 2007

²¹ <http://plato.stanford.edu/entries/egoism/>

²² <http://www.columbia.edu/ccnmtl/projects/mmt/udhr/index.html>

Case:

The case you should analyse is AirTex Aviation. The case can be found on pages 240 to 252 in edition 2 of the course book. The questions to be discussed are the following:

1. Was AirTex in a need for a new control system? Why/why not?
 2. Evaluate how the new control system at AirTex takes use of elements of results control, action control, cultural control and personal control.
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Introductory

AirTex Aviation was performing badly before the takeover and was in need of a new Management Control System. With the new owners Ted and Frank, the company was changed drastically and new MCS's were implemented by the new owners. With these changes the company was saved from the brink of financial failure. In this case analysis I will start with studying the problems prior to the takeover and then analyse the control systems used in the new system, what controls that were used and how effective they were. To finish, I will present another perspective of analysis, using a new typology for studying MCS's developed by T. Malmi and D. A. Brown (2008)²³.

Previous system

The main problem with the previous system was the centralized structure around the accounting division and Sarah Arthur. This meant several bad things from a MCS point of view:

- Inefficient centralization
- No planning activities, at least not that Sarah Arthur communicated to the rest of the company
- Managers don't know how they are performing
- Managers get punished for reasons that they don't understand
- No effort is spent on motivating managers to perform well

The *centralization* around Sarah Arthur was *inefficient*. She got all information, took most decisions on her own and didn't communicate with the rest of the company. Centralization can be good, it is a form of *administrative action control*. However, it requires that the level of competency of the person in the centre is higher than those who could have made the decisions instead²⁴. Sarah Arthur had no experience of the world of avionics, she wasn't even properly trained in accounting, which was her job. It is my belief that the company didn't benefit from the centralization, since the departments had better grounds for decision making.

No *planning activities* were presented in the case. This poses a problem, since the company doesn't gain any of the advantages of planning ahead. If there is no planning, how can managers set up goals and what is to prevent them from just working with extreme *myopia*?

²³ *Management control systems as a package—Opportunities, challenges and research directions*, Teemu Malmi and David A. Brown, Nov 2008, copyright Elsevier Ltd All rights reserved

²⁴ *Management Control Systems*, 2nd edition, page 122, Merchant and Van der Stede, 2007

Also, managers didn't get any results or measures of their performance and they got punished for not achieving goals that they had no idea existed. The company fails at the first point of efficient results control, *knowledge of desired results*²⁵. In the course literature it is stated that reward and punishments are the third thing you should focus on²⁶. Here they have punishments in the form of verbal reprimands, but since they don't even have a solid results measurement system to build the punishments on, they are useless, maybe even harmful.

The last problem is that managers aren't really motivated in any way to perform well for the company. Most of the managers seem to have a passion for flying or a strong loyalty to the company, however, aside from these factors, what keeps them working at the company and keeps them motivated? Nothing.

So, for the reasons above, it is my firm belief that AirTex was really in need of a new control system, as well as top management.

The new system

When Frank and Ted took over they changed the company. They took control from Sarah Arthur, decentralized the organization and gave managers responsibility and authority. Managers got responsible for their own receivables and were forced to keep track of their own performance in the new daily reports. Below I will analyse the different control systems used.

Action control

I could find three cases of action control in the new system.

- The Daily Department Report
- The Administration Profit Centre
- Responsibility for accounts receivable

The DDR is a form of action control that directs employees in what they should do. It specifies what managers should do, what they shall present and when they should do it. So, it is action control since it directly controls managers' actions. I can't really place it into one of the categories that the course literature defines, *behavioural constraints*, *preaction reviews*, *action accountability* and *redundancy*²⁷. I would place it under a category of *standardised behaviour* or something similar.

The DDR is linked to the company's results control system. I will get back to that later. The DDR makes sure that managers get a good view of their own performance and greatly made work easier for accounting and the administration department.

As for the administration profit centre, it is a form of *administrative behavioural constraint*. It takes away some authority and work from the managers, thus limiting managers' scope of action. It

²⁵ *Management Control Systems*, 2nd edition, page 32, Merchant and Van der Stede, 2007

²⁶ *Management Control Systems*, 2nd edition, page 393, Merchant and Van der Stede, 2007

²⁷ *Management Control Systems*, 2nd edition, page 687, Merchant and Van der Stede, 2007

centralizes things that the company doesn't want the managers to handle, and it has in the case had positive side effects, like less squabbling over work area.

A form of *action accountability* that is deployed in the new system is the managers' responsibility for accounts receivable. It follows all the steps that should exist in action accountability; *defining acceptable/unacceptable actions*, AirTex thinks it is unacceptable to collect money late; *communicating the definitions to managers*, AirTex has said to managers that they don't want their receivables to get old; *keeping track of behaviour*, managers are monitored by the administrative profit centre; *rewarding/punishing good or bad behaviour*, the departments are charged more depending on how old receivables are²⁸. Since AirTex isn't in a good financial situation, it is very important that they get cash and liquidity, something that this action control should succeed very well at.

Results control

One of the major factors of the new decentralized system in AirTex is the creation of *profit centres* and departments. Department managers were given 10% of their profit centres' profit after administrative charges. It is really a simple form of *results control*, however, it may be perfect for the situation. The measuring of just profits may not be perfect in measuring how managers create *economic value*, but it is simple, *understandability* is high. Managers know what profits are, how they are calculated and what they gain from generating profits. In this company where managers have no previous experience of results control, a simple system as this may be ideal.

As I stated before, results control are linked with actions control through the DDRs, in this case. The results control system uses profits as a measure, but the figures generated by the DDRs are also used. From the DDRs managers get a measure of their own performance. Since AirTex seems to have improved their situation since the takeover, the DDRs should have produced increasingly better results. That in itself is a reward for many people, to see that what they are doing is having a positive effect. Also, the measurements from the DDRs are *timely* and *understandable*, since they are generated every day and they are understandable for the managers for it is the managers who have produced the reports themselves.

Cultural control

I couldn't find many clear evidences of *cultural control* in the company. One thing that Frank and Ted did was to take steps to get Sarah Arthur out of the company culture. That was central since every manager were afraid, or at least very respectful, of her. What Frank and Ted did to change the culture was to simply say to managers that they could do many things that they previously weren't allowed to do. The example of the copier is an example of the change in company culture. Previously, no one would dare to purchase a copier, but with the new freedom of purchasing the manager of the Fuel Department purchased one.

²⁸ *Management Control Systems*, 2nd edition, page 78, Merchant and Van der Stede, 2007

Personal Control

Frank and Ted also employed personal control in their new system. To start with, they use *training* to counter problems like *personal limitations*. From the beginning managers don't know much about how to manage receivables or how you should behave as a manager. The DDRs were also part of the training. It allowed managers to learn from the system about what was efficient in their managing.

The course literature says that personal control also consists of making sure that the job is designed to allow success for the managers and providing them with resources²⁹. That is certainly true in this case. The company gives the managers much more *information* than before, and much more authority, which enables them to make a better job.

Another perspective

As I wrote before, the different control systems in this case are linked to each other, so it's hard to evaluate them separately. I found an article³⁰ which presents a new conceptual framework for analysing *packages* of management control systems. According to the article, MCS should be studied as packages since often there are interdependencies between the different MCS used in a case and therefore they are hard to analyse on an individual level.

The article gives a definition to MCS that is slightly different from the one presented in the book. They separate *decision supporting actions*, actions used to solely to enable good decision making, and *behavioural controls*, systems that influence behaviour in the organization. A difference from the book is that the article doesn't only look at operational control but also *strategic control*.

In the article are presented five different types of control that a package of MCS consists of. They are:

- *Planning controls* – It directs effort and behaviour, states what expectations on level of effort and behaviour that is needed and coordinates efforts within the company. The article separates long-range and short-range planning, like the course literature³¹. However, it distinguishes itself from Merchant and Van der Stede's theories by focusing not only on *financial planning*, but planning as a whole.
- *Cybernetic controls* – These controls measure performance in relation to set goals. The article recognized four types of cybernetic controls: budgets, financial measures, non-financial measures and hybrid measures. One interesting thing is that the article says is that a cybernetic system isn't necessarily related to MCS, it could be decision supporting instead. If managers produce the measurements themselves and act upon the results by themselves, the article categorises it as a decision supporting system.
- *Reward and compensation controls* – The article has made this separate in their typology. They reason that while some parts may be linked closely to cybernetic controls and

²⁹ *Management Control Systems*, 2nd edition, page 85, Merchant and Van der Stede, 2007

³⁰ *Management control systems as a package—Opportunities, challenges and research directions*, Teemu Malmi and David A. Brown, Nov 2008, copyright Elsevier Ltd All rights reserved

³¹ *Management Control Systems*, 2nd edition, page 330-332, Merchant and Van der Stede, 2007

increases the effort generated by each employee, the company uses rewards for other ends like retaining employees and using rewards in cultural controls.

- *Administrative controls* – These control organizational structure and set of standardized procedures. It is divided into organisation design and structure, governance structure, and procedures and policies.
- *Cultural controls* – The article has chosen to include what the course literature defines as personal controls in their definition of cultural controls. The article divides cultural controls into *value-based controls*, *symbol-based controls* and *clan controls*.

I will end this case analysis by using this framework to analyse the case after Ted and Frank's takeover.

We start with *planning controls*, or at least mentioning it. No planning activities, financial or non-financial, are presented in the case. This would imply that from the perspective of Malmi and Brown (2008)³² there is a lack of planning in the company.

Next is *cybernetic control*. AirTex measures managers performance by *financial measures*, and it is done by the accounting department, they calculate the results. Something that is a form of cybernetics control and intuitively is part of the MCS package is the DDR-system. However, as said above, this framework separates decision supporting systems from MCS's. If managers produce and if only they use it to evaluate their own performance, the cybernetic control is regarded as a *decision supporting system* and not a MCS. One last thing to mention from a cybernetic perspective is that the company seems to have no goal targets, something which is a substantial part of cybernetic control.

Rewards and compensation controls are used by AirTex. Managers get bonuses from the profits of their departments, as said earlier. Also, departments are charged different amounts of money depending on the age of the receivables. These rewards and punishments certainly increases efforts in the areas that they are given, but there is no use of rewards control to retain employees or for the use of cultural control.

The major factor under the category of *administrative controls* in this case would be the DDRs. The DDR-system is a procedure that managers have to follow and are therefore categorized as administrative controls. Also, Frank and Ted changed the organisation design and structure by decentralizing and by creating the administration profit centre. This took away focus from Sarah Arthur's accounting department and handed responsibility to the managers

As for *cultural controls* there wasn't much to find, except for what I wrote about cultural control and personal control in the other frameset. You could say that Frank and Ted took away the *symbol-based* power of Sarah Arthur.

³² *Management control systems as a package—Opportunities, challenges and research directions*, Teemu Malmi and David A. Brown, Nov 2008, copyright Elsevier Ltd All rights reserved

Conclusion

While both analyses of AirTex, using both frameworks, may have proven the management control system package to be lacking in some areas, the company has benefited greatly from the new system. As said in the course literature, MCS's are associated with costs and increase the probability of an organization achieving its goals, and more control isn't necessarily better³³. One improvement that the company could do is to set goals and plan, maybe they d, but the case doesn't mention it. Since the company is performing very well after the implementation of the new system, it is my belief that we can call the MCS package sufficient.

³³ *Management Control Systems*, 2nd edition, page 4-5, Merchant and Van der Stede, 2007

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Evaluation of my performance

To study the contents of this course I have mainly read the book and participated in lectures. I haven't read any cases except for the ones that you should have read before each lecture. I felt that I could contribute with something almost every lecture, unfortunately I had some problems hearing what some of the other students were saying, so sometimes I could quite follow the chain of reasoning.

I have also tried to hand in a paper before each lecture, though I missed Armco and the Beifang cases. I knew that it would be much easier to write the homework assignment and to participate in lectures if I read the cases beforehand.

As for the seminar, I feel that I could have performed better, I felt that Christoffer got the heaviest burden. Still, the seminar itself went well and the produced report was acceptable.

I would like to thank you for the course Håkan and though it has been a lot to do, I feel that I have gained new perspectives from it. Thank you.