

# Designing of Management Control Systems

Lecture 02

Kanchan Damithendra

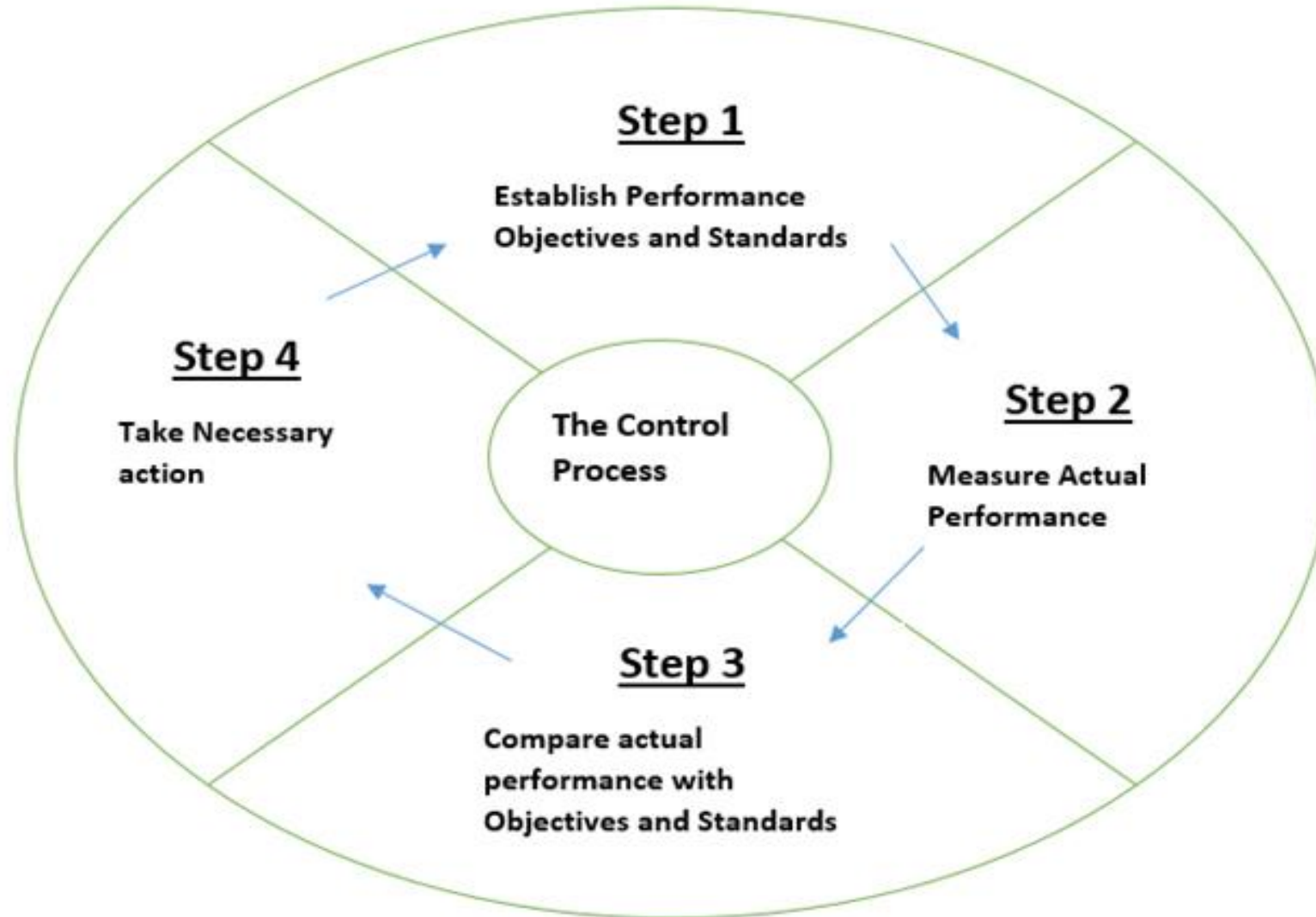
# Designing of MCS

- What the organization wants from each employee individually?  
(CEO to floor level)

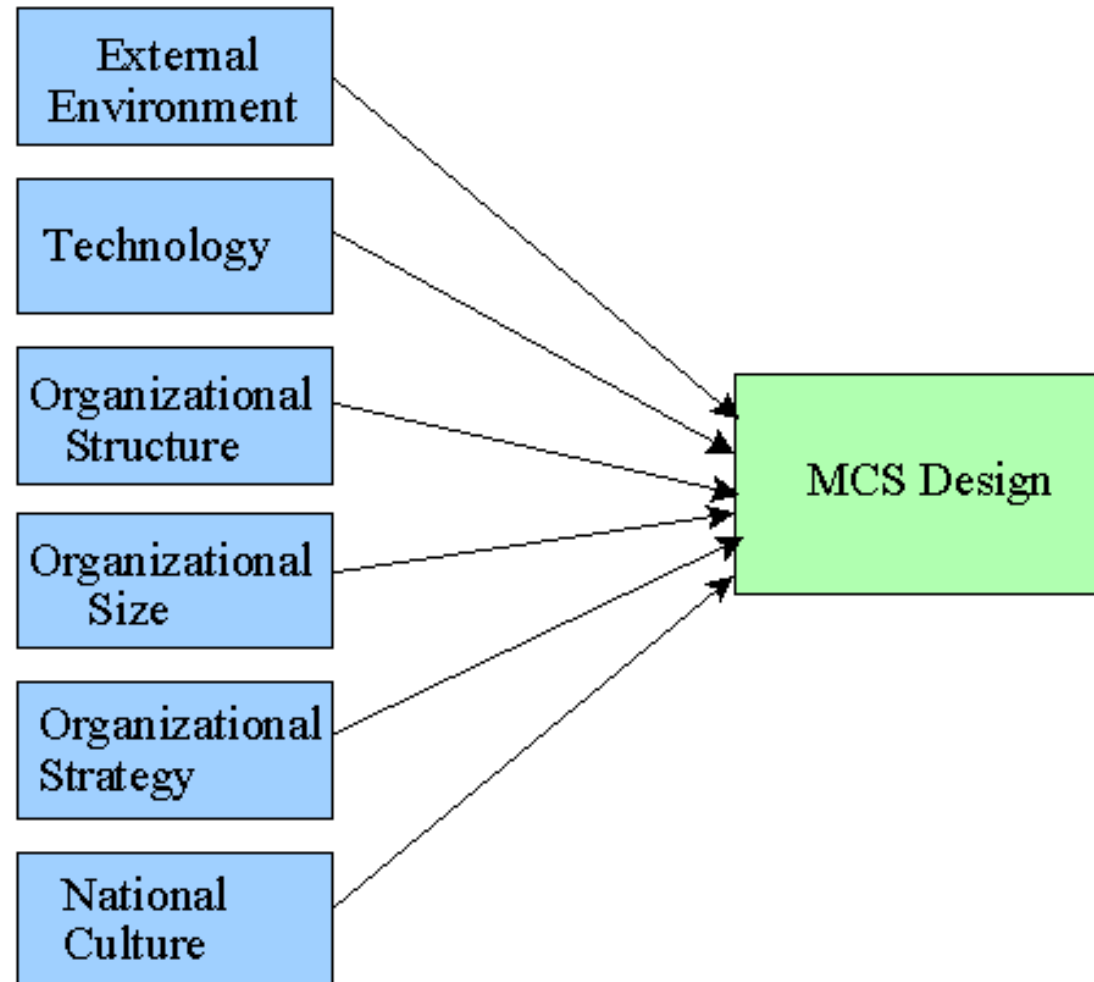
## Key Steps-

- 1) Setting performance standards
- 2) Measure & compare results (Actual/Planned)
- 3) Evaluate results (Feedback/coach)
- 4) Take actions (corrective/preventive)

# Designing of MCS



# Factors to be considered



# External Environment

- Suppliers
- Customers
- Government

# Technology

- IT infrastructure
- Information systems used
- Technical competency
- Knowledge of the people

# Organizational Structure

- Functional, divisional & matrix
- Centralized/Decentralized
- Entrepreneurial/corporate

# Organizational Size

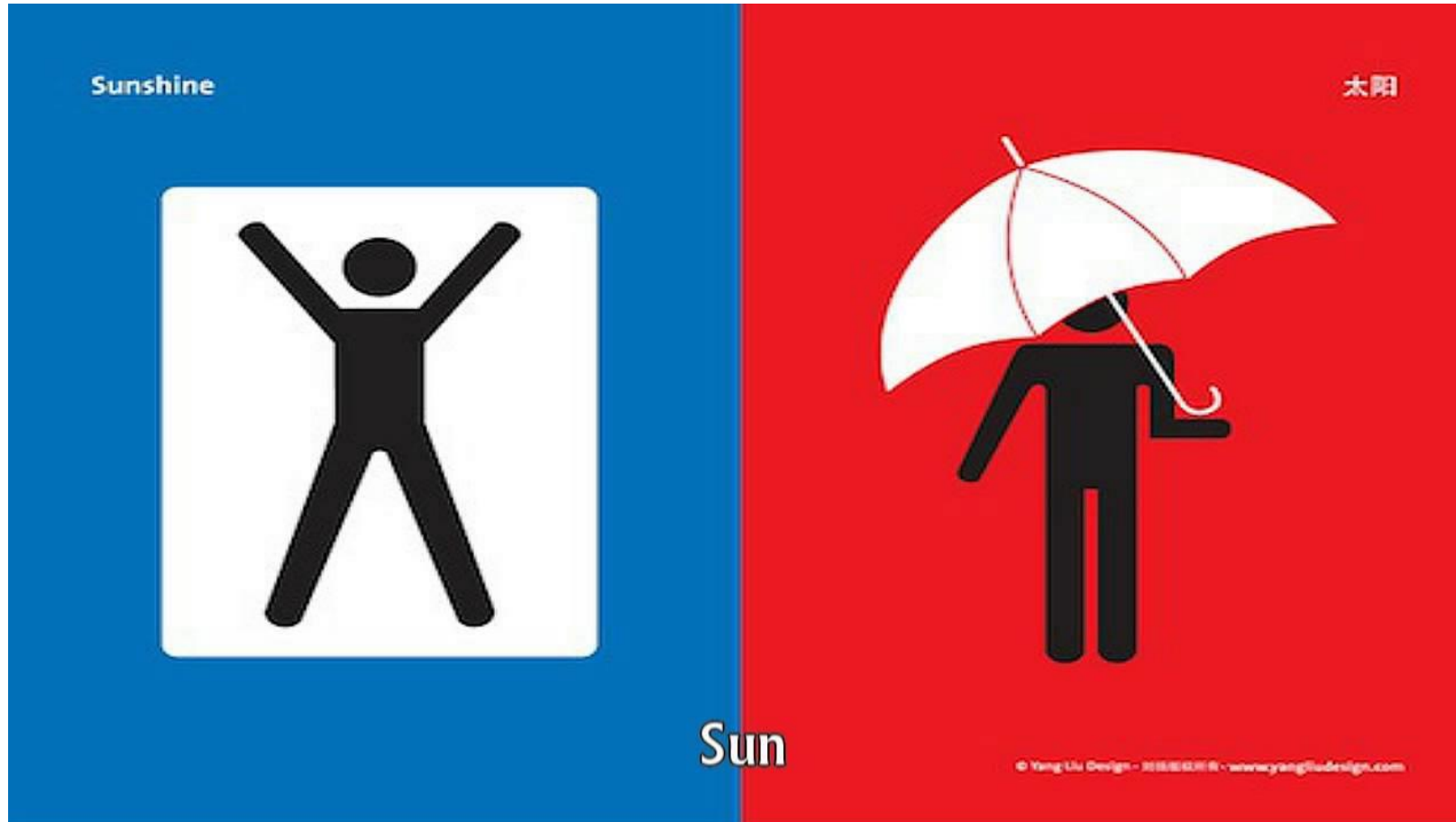


# Organizational Strategy

# Culture

- Culture becomes an important asset of an organization when it is properly imbibed in an organization
- Conversely, it is a liability when it adapts poorly to the environmental needs of the organization
- In an organization when the goals and values are shared by the individual members, problems are minimized and a sense of group loyalty prevails

# Cultural Differences..



# Corporate Culture

## IBM's Strategy:

- Respect for the individual
- Customer service
- Dedication to work towards excellence
- Decentralized business
- Total quality management
- Empowerment of people



IBM strives to foster a company culture based on core values that defines the role that we can and should play in society.



# Corporate Culture

<https://www.youtube.com/watch?v=EcHpgsTg458>



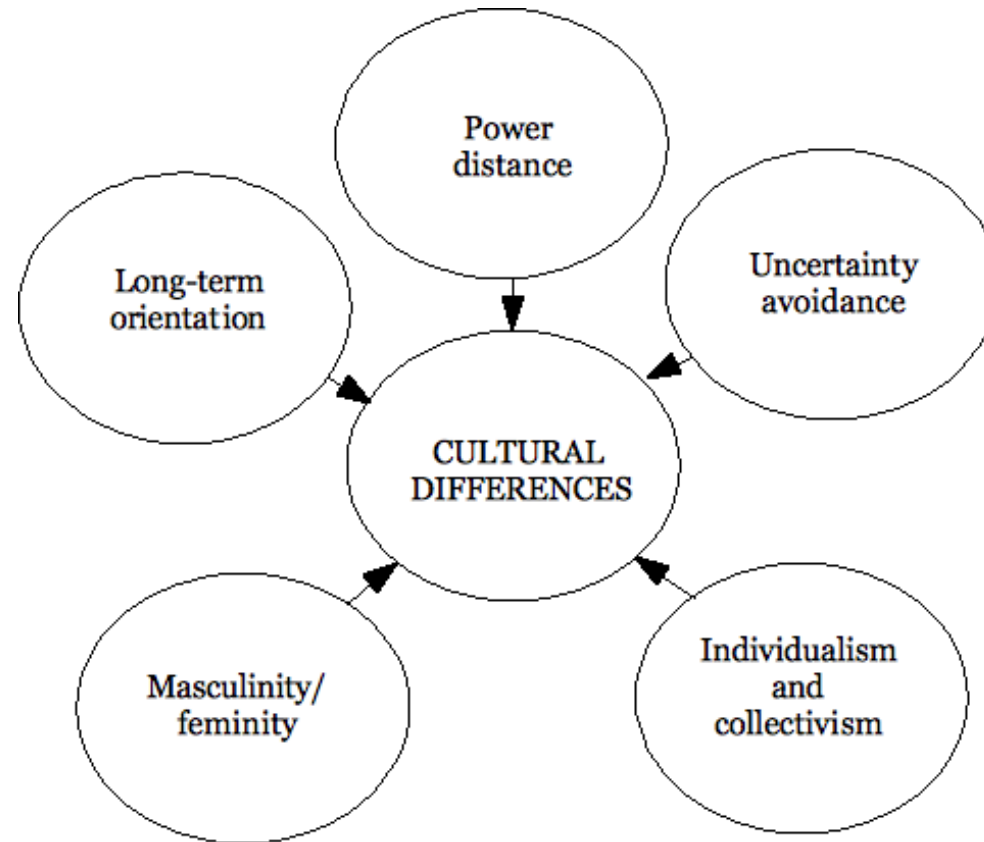
# CULTURAL CONFLICTS IN WORKPLACE



A person acts according to the values and norms of his or her culture; another person holding a different worldview might interpret his or her behavior from an opposite standpoint. This situation creates misunderstanding and can lead to conflict.

# Hofstede's Cultural Dimensions

- Describes the effects of a society's **culture** on the values of its members, and how these values relate to behavior, using a structure derived from factor analysis



# Factors...

<b>Power Distance</b>	The extent to which the less powerful members of institutions and organisations within a country expect and accept that power is distributed unequally
<b>Individualism</b>	The degree of interdependence a society maintains among its members
<b>Masculine/ Feminine</b>	Masculine society measure of success is achievement & winning. Feminine society measures success by quality of life. Standing out from the crowd is not admirable
<b>Uncertainty Avoidance</b>	The extent to which the members of a culture feel threatened by ambiguous or unknown situations and have created beliefs and institutions that try to avoid these.
<b>Long Term Orientation</b>	The extent to which a society shows a pragmatic future-oriented perspective rather than a conventional historical short-term point of view.



# Important!

- The process of establishing controls should be seen as a constructive exercise that will help in enhancing the performance of the employees.
- The standards set should be challenging, but at the same time, attainable.
- The objectives should be measurable to enable evaluation of performance.
- Controls should focus on the objectives and key results of an activity.
- There should be a restricted number of objectives.
- There should not be too much focus on easily measurable factors and short-run variables. Attention should be paid to all the important variables in a balanced fashion.
- Responsibility for results should rest with a single individual to avoid duplication of work.

# Formal vs. Informal Sanctions

## Formal Sanctions

- Reward or punishment given by a formal organization or regulatory agency
- Ex: low grades, suspension
- Ex: fired from job
- Positive formal sanctions: diploma, pay raise, medals



## Informal Sanctions

- Spontaneous expression of approval or disapproval given by an individual or group
- Positive Example: compliments, smiles, standing ovation
- Negative Example: insults, gossip, ostracism
- Effective amongst teenagers who consider group acceptance important



# Responsibility Centres

An individual part of the business whose manager has personal responsibility for its performance.



Managers to plan & control areas of performance on which they are measured.

# Revenue Centre

- Primarily responsible for generating sales revenue
- Manager does not possess control over cost/investment in assets
- Acquires finished goods and responsible for selling them
- No control over pricing but responsible for volumes/variances
- Performance is evaluated by actual revenue VS budgeted revenue, and actual marketing expenses VS budgeted marketing expenses

e.g- Marketing Department, Sales representatives

# Consider the activities of an automobile service station owned by a large automobile company:

- The service center manager has no control over the cost of items such as fuel, depreciation on the building, power and heating, supplies, and salary rates.
- The service manager also has no control over the wages paid to employees—the head office staff controls them, and the central marketing staff controls all product pricing and promotional activities.
- The manager has a minor influence, through scheduling and staffing decisions, on total labor costs—level of the repair activities determine all other costs.
- The major controllable item in this service station is customer service, which distinguishes its repair services from those offered in similar outlets and helps to determine the service station's sales levels.

# Cost Centres

- Widely used form of responsibility centres
- Responsible for cost but not for revenues
- E.g?

There are two types of cost centres

- ✓ Engineered expense centre
- ✓ Discretionary expense centre

# Engineered Cost Centre

- Engineered costs are for which the 'right' or 'proper' amount can be estimated with reasonable reliability'
- Inputs can be measured in monetary terms
- I/O relationship is known
- The optimum amount of input required to produce one unit of output can be determined
- Usually found in manufacturing operations, warehousing, distributions

# Discretionary Cost Centre

- Discretionary costs (managed costs) for which no such engineered estimate is feasible.
- The costs incurred depend on the management's judgment as to the appropriate amount under the circumstances.

E.g. number of staff members

- Management's view about the proper level of costs is subject to change with change in management.
- Includes administrative and support units like accounting, legal, PR, HR, R&D, operations
- The output cant be measured in monetary terms
- The difference between budget and actual expense is not a measure of efficiency rather, it is simply the difference between the budgeted input and the actual input and does not incorporate the value of the output



# Profit Centres

- Performance is measured in terms of the numerical difference between revenues (outputs) and expenditure (inputs)
- It is involved in the manufacture and sale of outputs, and it measures how well the center is doing economically.
- The profit center also determines the efficiency of the manager in charge of the center.
- Helps in motivating managers to perform well in areas they control and also encourages managers to take initiatives
- The profit center helps the organization to make the best use of specialized market knowledge of the divisional managers, and entrusts the local managers the responsibility of tradeoffs



# Profitability Measures

# Investment Centres

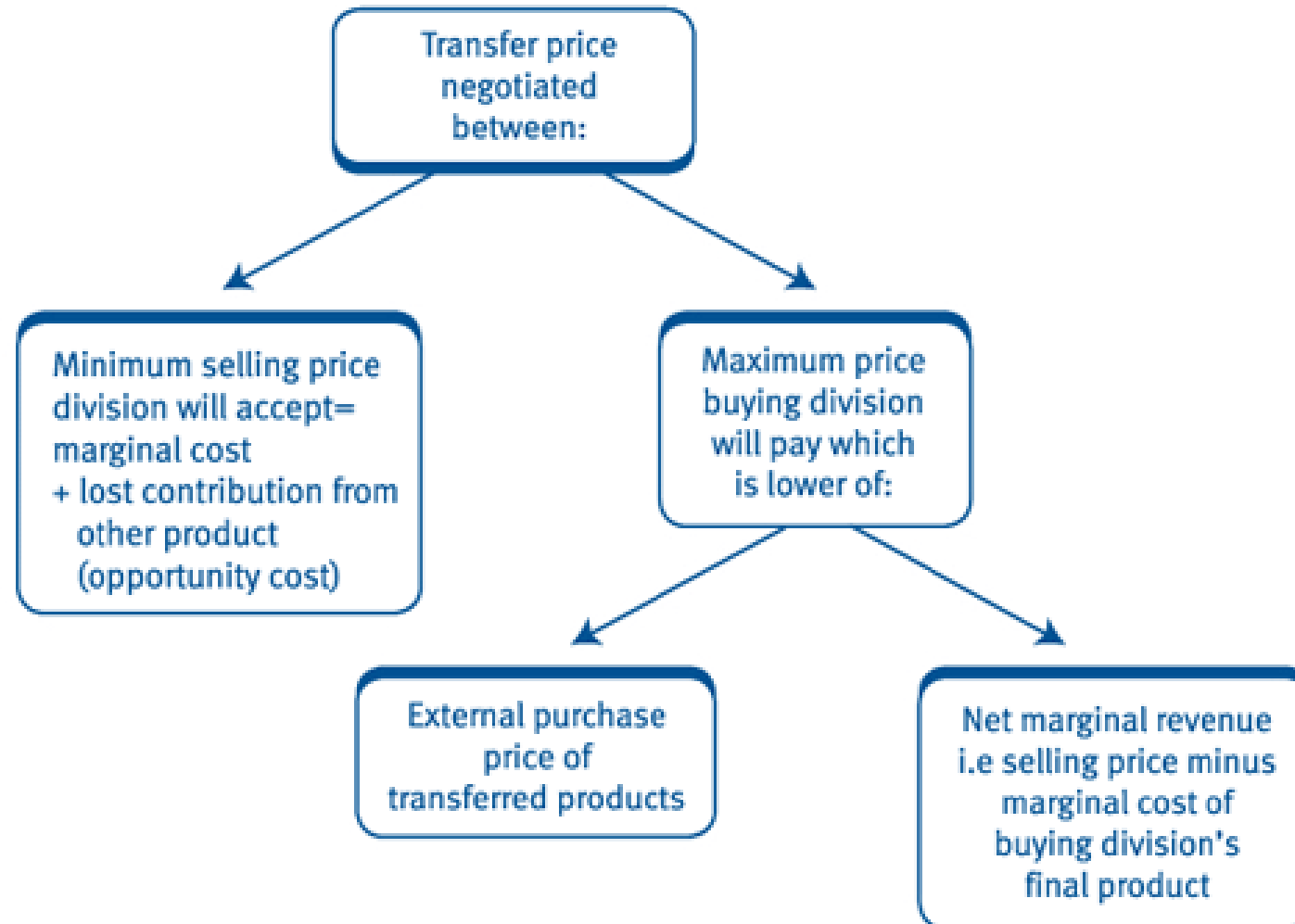
- Has control over sales revenues and operating costs, and the assets used to generate profit
- An investment unit manager must be in a position to influence the size of the investment and profit variables
- An investment center is a measure of economic performance, and it analyzes all elements of profit and investment
- The objective of this center is to maximize profit, given the amount of investment required to generate the profit

# Transfer Pricing

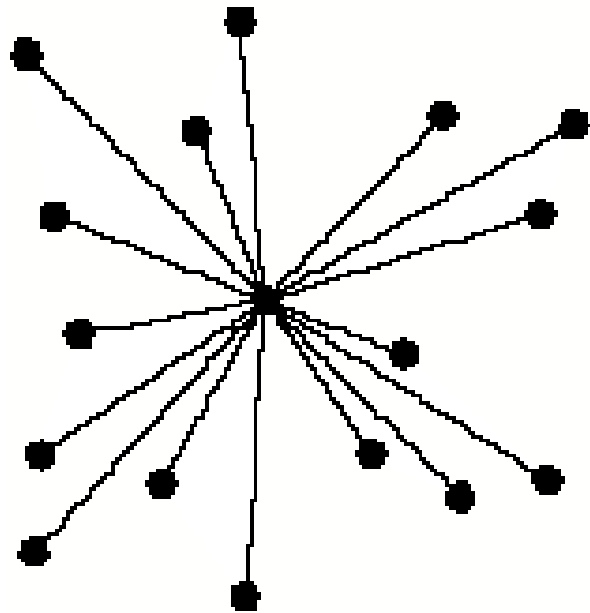
- The price at which divisions of a company transact with each other
- Transactions may include the trade of supplies or labor between departments
- Transfer prices are used when individual entities of a larger multi-entity firm are treated and measured as separately run entities

(Investopedia)

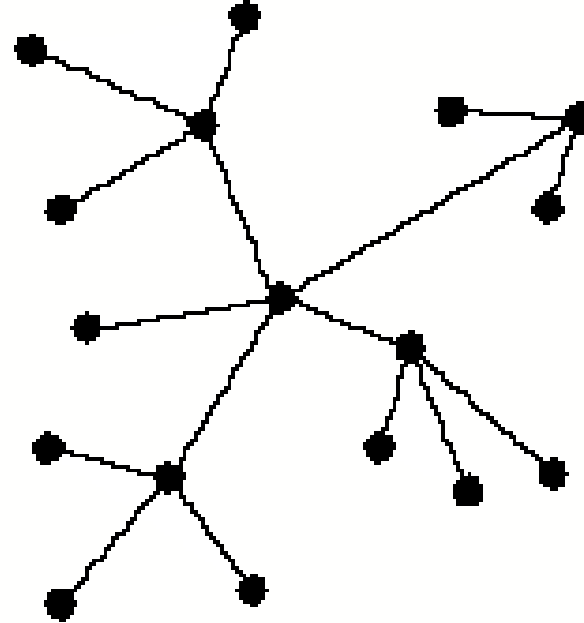
# Transfer Pricing



# Decentralized Organizations



**CENTRALIZED**



**DECENTRALIZED**

# What is it?

- Senior management has shifted the authority for some types of decision making to lower levels in the organization
- This usually means that the manager of a cost center, profit center, or investment center has the authority to make decisions that impact his or her area of responsibility

# Appropriateness...

- Where a strong level of individualized customer service is needed, usually at the point of contact with customers
- Where there are many store locations, so that senior management cannot reasonably monitor or make decisions for all locations
- Where there is considerable competition, so that a myriad of decisions must be made to respond to competitor actions
- Where innovations change the business model constantly, so that no centralized control is possible



# Advantages & Disadvantages