Organizational Control

Concept, process and importance
Techniques of controlling-Traditional and Modern Techniques of Control

Organisational control

- An effective organization is one where managers understand how to manage and control.
- Without enough control systems in place, confusion and chaos can overwhelm an organization.
- The term control has different connotations depending upon the context of the use of the term.
- In manufacturing it refers to a Device or mechanism installed or instituted to guide or regulates the activities or operation of an apparatus, machine, person, or system; in law it refers to controlling interest and ***in management as an authority to order and manage the workings and management of an entity.***

Process of organisational control

1. **Establish standards to measure performance w**ithin an organization's overall strategic plan, managers define goals for organizational departments in specific, operational terms that include standards of performance to compare with organizational activities.
2. **Measure actual performance.** Most organizations prepare formal reports of performance measurements that managers review regularly. These measurements should be related to the standards set in the first step of the control process. For example, if sales growth is a target, the organization should have a means of gathering and reporting sales data.

Process of organisational control

3. **Compare performance with the standards.** This step compares actual activities to performance standards. When managers read computer reports or walk through their plants, they identify whether actual performance meets, exceeds, or falls short of standards.

4. Take corrective actions. When performance deviates from standards, managers must determine what changes, if any, are necessary and how to apply them.

Importance of organisational control

(1) Reduces Risk:

- Control eliminates the risk of non-conformity of actual performance with the main goals of the organisation. Control is the function which regulates the operation to ensure the attainment of the set objectives.
- Regular measurement of work in progress with proper adjustments in operations puts the performance on the right track and helps in the achievement of goals.

(2) Basis for Future action:

- Control provides the information and facts to the management for planning and organising when the work is completed and the result is evaluated.
- It would be better to say that future long term planning is not possible unless and until control information is available in time to the managers for the operation of work.

(3) Size of the business:

In large scale business in the modem times it is quite impossible to work without proper policies, procedures and quality of different varieties of goods. That is why in a large scale organisation there is always the need of a scientific system of control to solve the day to day problems.

4) Indicator for managerial weakness:

In the organisation there will be certain unforeseen and unknown problems which cannot be traced out by mere planning, organising and staffing efforts. It is the control process that can trace these out. Control not only finds out the weakness of managers but also provides solutions and remedial action to solve the problems.

(5) Facility of coordination:

- Management and coordination of the business activities and workers is a very important role. It binds all the workers and their activities and motivates them to move towards the common objectives through coordination.
- Control will play the role of a middleman between the workers and management to provide the required information in time to the workers.

(6) Simplifies supervision:

A systematic system of control helps in finding out the deviation existing in the organisation which also simplifies the task of the supervisor in managing his subordinates. So through control its becomes simpler for the supervisor to supervise and guide the workers to follow the right track and fulfil the required goals.

Limitations of Control

Limitations of organisational control

- Difficulty in Setting Qualitative Standards
- Costly affair
- Resistance from employees
- No control over external factors

Sometimes control creates a chocking within the organisation which should be avoided in every possible manner.

Planning as an important element of Control

Planning and Controlling

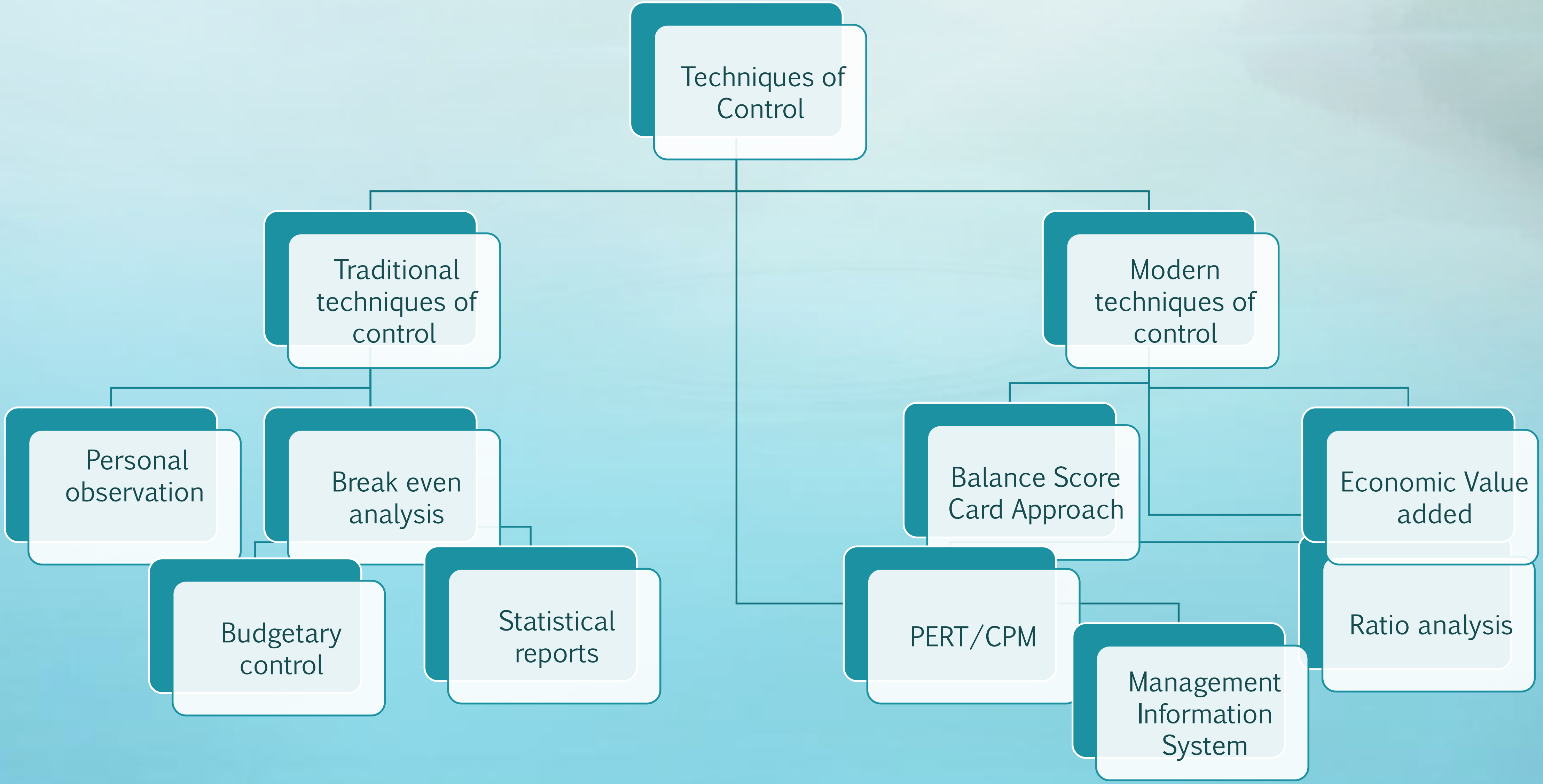
- Planning and controlling are two separate functions of management.
- Planning is all about looking ahead whereas controlling is about looking back. To quote another difference we can say that planning is first function of management and controlling is the last. Despite these differences they are closely related.
- Planning and controlling reinforce each other.

- *Planning can be successful only in the presence of controlling. If the process of controlling is taken away from management, no person working in the enterprise will take it seriously to work according to the plans and consequently, the plans will fail. Hence we can say planning is meaningless without controlling.*

&

- *Controlling is blind without Planning. Under the system of controlling actual work performance is compared with the standards. Hence, if the standards are not determined there is no justification left for control, and the standards are determined under planning.*

Techniques of Control in an Organisation


Techniques of Control
Traditional techniques of control
Personal observation
Break even analysis
Budgetary control
Statistical reports
Modern techniques of control
Balance Score Card Approach
Economic Value added
PERT/CPM
Management Information System
Ratio analysis

Personal Observation

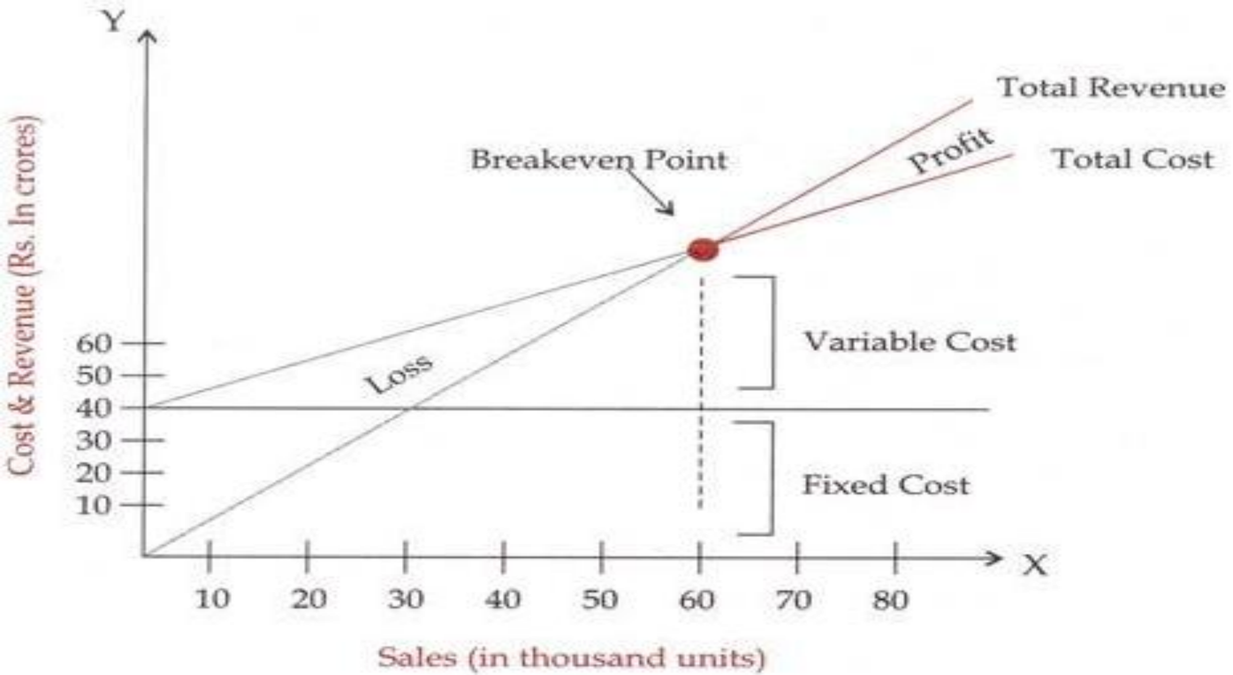
- This is the most traditional technique of control.
- It helps a manager to collect first hand information about the performance of the employees.
- It also creates psychological pressure on the employees to improve their performance as they are aware that they are being observed personally by the manager.
- However, this technique is not to be effectively used in all kinds of jobs as it is very time consuming.
- It is also a very subjective approach, as managers may make judgements on the basis of their personal biases and prejudices.

Statistical reports

- Statistical analysis in the form of percentages, ratios, averages etc. in different areas provides useful information regarding performance of an organisation to its managers.
- When such information is presented in the form of tables, graphs, charts etc., it facilitates comparison of performance with the standards laid and with previous years' performance.
- Statistical tools not only helps with quantitative figures but lot of advancements in the field of statistical techniques (such as Correlation, Regression, structural Equation Modelling) helps in conducting behavioural research in organisation which helps in learning and training in organisation.
- However statistical data need to be interpreted carefully. They should be taken as tool to supplement human knowledge rather than substitute of it.

Break Even Analysis

- The technique used by managers to study the relationship between sales volume, costs and profit is known as Breakeven Analysis. This technique helps the managers in estimating profits at different levels of activities. The following figure shows breakeven chart of a firm.
- The point at which the tot
is breakeven point.



- Breakeven Point= Fixed Cost/ (Selling Price per unit- Variable cost per unit).
- Break even analysis helps us in knowing the level of output after which the firm will start earning the profits.
- It works as a siren for organisation cost control. A firm can keep a check on its variable cost through this analysis.
- A firm with high fixed cost in its cost structure need to produce at large scales to break even.

Budgetary control

- Budgetary control refers to how well managers utilize budgets to monitor and control costs and operations in a given accounting period.
- In other words, budgetary control is a process for managers to set financial and performance goals with budgets, compare the actual results, and adjust performance, as it is needed.
- Budgetary control is done for all aspects of a business such as income, expenditure, production, capital and revenue. It is like a report card in school. It shows how well you performed in that subject during the school year.
- Budgetary control is done by the budget committee.

Four main steps in budgetary control

First, a budget needs to be created. Generally budget is prepared related to all functional areas such as production budget, sales budget, cost budget etc.

Second, after the budget is created, management needs to compare, analyze, and interpret the actual performance results with the budgeted goals.

Third, after the comparison has been made, managers need to improve the under performing operations and continue to strengthen the favorable ones.

Fourth and final step usually occurs at the end of an accounting period. After management has a chance to look over the entire last period, they can start making plans for the next year.

Different types of budgets

Financial budgets

- Cash budget
- Capital expenditure budget
- Balance sheet budget

Operating budgets

- Revenue budget
- Expense budget
- Profit budget

Non-operating budgets

- Fixed cost budget
- Variable cost budget

Advantages of budgetary control

- The working of different departments and sectors is properly coordinated. The budgets of different departments have a bearing on one another.
- It ensures that the planning of expenditure will be systematic and there will be economy in spending. The finances will be put to optimum use.
- In the absence of a budgetary control system the deviations can be determined only at the end of the financial period.
- It creates budget consciousness among the employees. By fixing targets for the employees, they are made conscious of their responsibility.

Limitations

- The budgets are prepared for the future period. The future is always uncertain and the situation which is presumed to prevail in future may change. The change in future conditions upsets the budgets which have to be prepared on the basis of certain assumptions.
- Budgetary control may lead to conflicts among functional departments. Every department tries to get maximum allocation of funds and this raises a conflict among different departments.
- It is a costly and time consuming process. Because of future uncertainties, assumed conditions may not prevail necessitating the revision of budgetary targets.

Essentials of budgetary control

- Key to successful budgeting is to set appropriate standards. Many budgets fail for lack of such standards. Standards should be clear, quantifiable and achievable.
- Budget making and administration must receive the whole-hearted support of top 'management' for accomplishing the budget goals.
- Besides the support of top management, the concerned managers at lower levels should also participate in its preparation.
- For budgetary control to work well, right information at right time should be made available to the analysts.

Modern Techniques of Control

Balanced score card approach

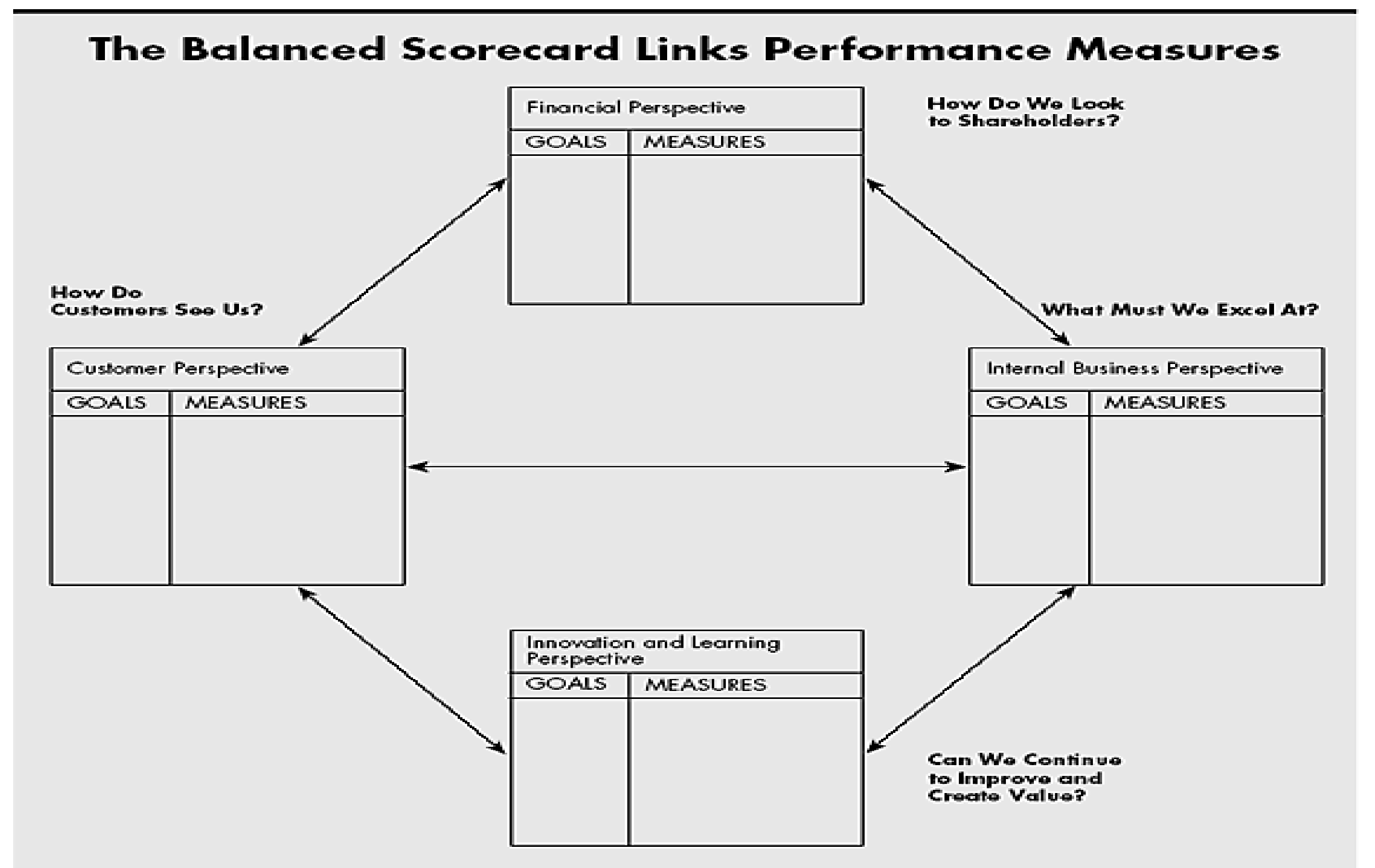
A stakeholder's approach to control

Balance score card approach

- What you measure is what you get.
- Traditional financial accounting measures like return-on-investment and earnings-per-share can give misleading signals for continuous improvement and innovation—activities today's competitive environment demands.
- The traditional financial performance measures worked well for the industrial era, but they are out of step with the skills and competencies companies are trying to master today.

- Balanced scorecard"—a set of measures that gives top managers a fast but comprehensive view of the business.
- The balanced scorecard includes financial measures that tell the results of actions already taken.
- And it complements the financial measures with operational measures on customer satisfaction, internal processes, and the organization's innovation and improvement activities—operational measures that are the drivers of future financial performance.

The balanced scorecard allows managers to look at the business from four important perspectives.



The Balanced Scorecard Links Performance Measures

- How do customers see us? (customer perspective)
- What must we excel at? (internal perspective)
- Can we continue to improve and create value? (innovation and learning perspective)
- How do we look to shareholders? (financial perspective)

While giving senior managers information from four different perspectives, the balanced scorecard minimizes information overload by limiting the number of measures used.

- By combining the financial, customer, internal process and innovation, and organizational learning perspectives, the balanced scorecard helps managers understand, at least implicitly, many interrelationships.
- This understanding can help managers transcend traditional notions about functional barriers and ultimately lead to improved decision making and problem solving.
- The balanced scorecard keeps companies looking—and moving—forward instead of backward.

A balance score card of a company will look something like this…

ECI's Balanced Business Scorecard

Financial Perspective

GOALS	MEASURES
Survive	Cash flow
Succeed	Quarterly sales growth and operating income by division
Prosper	Increased market share and ROE

Customer Perspective

GOALS	MEASURES
New products	Percent of sales from new products Percent of sales from proprietary products
Responsive supply	On-time delivery (defined by customer)
Preferred supplier	Share of key accounts' purchases Ranking by key accounts
Customer partnership	Number of cooperative engineering efforts

Internal Business Perspective

GOALS	MEASURES
Technology capability	Manufacturing geometry vs. competition
Manufacturing excellence	Cycle time Unit cost Yield
Design productivity	Silicon efficiency Engineering efficiency
New product introduction	Actual introduction schedule vs. plan

Innovation and Learning Perspective

GOALS	MEASURES
Technology leadership	Time to develop next generation
Manufacturing learning	Process time to maturity
Product focus	Percent of products that equal 80% sales
Time to market	New product introduction vs. competition

ECI's Balanced Business Scorecard

Financial Perspective

GOALS	MEASURES
Survive	Cash flow
Succeed	Quarterly sales growth and operating income by division
Prosper	Increased market share and ROE

ECI's Balanced Business Scorecard

Customer Perspective

GOALS	MEASURES
New Products	Percent of sales from new products Percent of sales from proprietary products
Responsive supply	On-time delivery (defined by customer)
Preferred supplier	Share of key accounts' purchases Ranking by key accounts
Customer partnership	Number of cooperative engineering efforts

ECI's Balanced Business Scorecard

Internal Business Perspective

GOALS	MEASURES
Technology capability	Manufacturing geometry vs. competition
Manufacturing excellence	Cycle time Unit cost Yield
Design productivity	Silicon efficiency Engineering efficiency
New product Introduction	Actual Introduction schedule vs. plan

ECI’s Balanced Business Scorecard

Innovation and Learning Perspective

GOALS	MEASURES
Technology leadership	Time to develop next generation
Manufacturing learning	Process time to maturity
Product focus	Percent of products that equal 80% sales
Time to market	New product Introduction vs. competition

Accounting measures of control

Return on investment and
Ratio analysis

3. Return on Investment

- Return on investment is very useful technique for determining whether the capital invested in the business has been effectively used or not for generating reasonable amount of return.
- Return on Investment= (Net Income / Total Investment) X 100 Net Income before or after tax can be used for calculating ROI.
- Total investment includes investment in fixed Assets as well as working capital.
- It acts as an effective control device in measuring and comparing the performance of different departments. It also helps departmental managers to find out the problems which adversely affect ROI.

4. Ratio analysis

Ratio Analysis is a technique of analysing the financial statements of a business firm by computing different ratios. Various ratios are explained as follows:

1. Liquidity Ratios:

Liquidity ratios are calculated to know short term financial position of business and its ability to pay short term liabilities. It includes current ratio and quick ratio.

a. Current Ratio = Current Assets/Current Liabilities

b. Quick Ratio = Cash + Bills Receivable/Current Liabilities

2. **Solvency ratios** are calculated to know long term solvency of the business and its ability to pay its long term debts. It includes debt equity ratio, proprietary ratio, interest coverage ratio etc.

a. Debt Equity Ratio= Debt/Equity Share Holders Fund

b. Proprietary Ratio = Shareholders fund/Total Assets

3. **Profitability ratios** like gross profit ratio, net profit ratio, operating ratio, etc. help to analyze the profitability position of a business.

a. Gross Profit Ratio = Gross Profit/Net Sales × 100

b. Net Profit Ratio = Net Profit/Net Sales x 100

4. **Turnover Ratios:**

The various turnover ratios like Inventory turnover ratio, debtors turnover ratio, fixed assets turnover ratio etc. help in knowing whether the resources are effectively used for increasing the efficiency of operations of business or not. Higher turnover indicates better utilization of resources.

a. Inventory Turnover Ratio = Cost of goods sold/Average Stock

b. Debtors Turnover Ratio = Net Credit Sales/Average Accounts Receivables

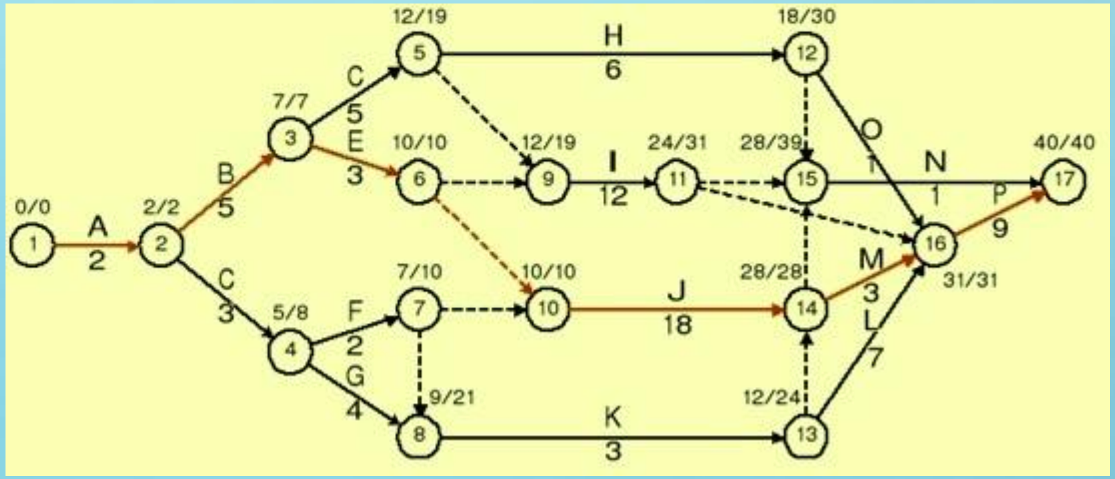
5. PERT-CPM

- Programme Evaluation and Review Technique (PERT) and Critical Path Method (CPM) techniques were developed in USA in the late 50's.
- These techniques are used to compute the total expected time needed to complete a project & it can identify the bottleneck activities that have a critical effect on the project completion date.
- Such techniques are mainly used in areas like construction projects, aircraft manufacture, ship building etc.

Steps involved in these PERT/CPM

- The project is first divided into various activities and then these activities are arranged in a logical sequence.
- A network diagram is prepared showing the sequence of activities.
- Time estimates are laid down for each activity.
- PERT prepares three time estimates-(i) Optimistic (shortest time) (ii) Most likely time & (iii) Pessimistic (longest time).
- In CPM, only one time estimate is prepared. Along with this, CPM also lays down the cost estimates for completing the project. The most critical path in the network is the longest path. Longest path consists of those activities which are critical for completing the project on time; hence the name CPM.
- If required, necessary changes are made in the plan for completing the project on time.

- PERT was originally designed to examine projects from the stand points of uncertainty while the CPM was designed to examine projects from the standpoint of costs.
- These techniques have been combined over time. Both the techniques rely heavily on the use of networks to help plan and display the coordination of all the activities of a project.
- Over time, CPM and PERT merged into one technique referred to as ‘PERT/CPM’. In merged technique it is visually easier to see precedence relationships. It consists of a network of branches and nodes and is ideal for large projects with many activities.



6. Economic value added

- Economic Value Added (EVA) or Economic Profit is a measure based on the Residual Income technique that serves as an indicator of the profitability of projects undertaken.
- Originally proposed by the consulting firm Stern Stewart & Co. (USA), a pioneer in the field, **Economic Value Added (EVA)** is currently a very popular idea. Stewart & Co. has got a registered trade mark by the name EVA – an acronym for Economic Value Added.

- The formula for calculating EVA is: Net Operating Profit After Taxes (NOPAT) - Invested Capital * Weighted Average Cost of Capital (WACC).

- The idea behind EVA is that shareholders must earn a return that compensates for the risk taken. If EVA is zero; it is treated as a sufficient achievement on the ground that shareholders earned a return that compensated the risk.

- Its underlying premise consists of the idea that real profitability occurs when additional wealth is created for shareholders and that projects should create returns above their cost of capital.

EVA as a control technique

- EVA assesses the performance of a company and its management through the idea that a business is only profitable when it creates wealth and returns for shareholders, thus requiring performance above a company's cost of capital.
- EVA is a good guide for investors; as on the bias of EVA, they can decide whether a particular company is worth investing money in or not.
- EVA can be used as a basis for valuation of goodwill and shares.
- EVA is a good controlling device in a decentralised enterprise. Management can apply EVA to find out EVA contribution of each decentralised unit or segment of the company.

- More than 300 companies all over the world have adopted EVA framework for financial management. The leading companies that have put EVA model into practice include Coca-Cola (which introduced it in 1981), Infosys, Hindustan Lever, Chemin or Drugs etc.
- However, the EVA calculation relies heavily on the amount of invested capital, and is best used for asset-rich companies that are stable or mature. Companies with intangible assets, such as technology businesses, may not be good candidates for an EVA evaluation.

Management Information System

- Management Information System (MIS) is a computer based information system which provides accurate, timely and up-to-date information to the managers for taking various managerial decisions.
- It provides timely information to the managers so that they can take appropriate corrective measures in case of deviations from standards.

- It provides only relevant information to the managers thus saving them him from information overload.
- It facilitates collection and management of information at different levels and departments of the organisation.
- It helps in planning, controlling and decision making at all levels of an organisation.
- It helps in improving the quality of information.
- It ensures cost effectiveness by providing all important information to the management in time.

Thankyou