Chapter 14

Managerial and Quality Control

Chapter Outline

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Annotated Learning Objectives

After studying this chapter, students should be able to:

1. **Define organizational control and explain why it is a key management function.**
   
   Organizational control is defined as the systematic process through which managers regulate organizational activities to make them consistent with the expectations established in plans, targets, and standards of performance. Control, especially quality control, is an issue facing every manager in every organization today.

   Control is a key management function because it is the mechanism managers use to steer the organization toward its objectives. Organizational control is a process of ensuring that objectives are met and that resources are allocated in the best way to achieve those objectives.

2. **Describe differences in control focus, including feedforward, concurrent, and feedback control.**
   
   Control can focus on events before, during, or after a process. These three types of control are formally called feed forward, concurrent, and feedback.

   Feed forward control attempts to identify and prevent deviations before they occur. Sometimes called preliminary or preventive control, it focuses on human, material, and financial resources that flow into the organization.

   Concurrent control monitors ongoing employee activities to ensure they are consistent with quality standards. Concurrent control assesses current work activities, relies on performance standards, and includes rule and regulations for guiding employee tasks and behaviors.

   Feedback control, sometimes called postaction or output control, focuses on the organization’s outputs – in particular, the quality of an end product or service. Many feedback controls focus on financial measurements.

3. **Explain the four steps in the control process.**

   Based on our definition of organizational control, a well-designed control system consists of the following four key steps:

   Establish standards of performance. Managers define goals for organizational departments in specific, operational terms that comprise a standard of performance against which to compare organizational activities.

   Measure actual performance. Managers develop quantitative measurements of performance that can be reviewed on a daily, weekly, or monthly basis.

   Compare performance to standards. This is an explicit comparison of actual activities to performance standards.

   Feedback. Corrective action is a change in work activities to bring them back to acceptable performance standards.
4. **Discuss the use of financial statements, financial analysis, and budgeting as management controls.**

Budget and financial controls tell whether the organization is on sound financial footing and they can be useful indicators of other kinds of performance problems. Managers need to be able to evaluate financial reports that compare their organization’s performance with earlier data or industry norms. The most common financial analysis focuses on ratios. Liquidity ratios, activity ratios, profitability ratios, and leverage ratios are among the most common ratios. Budgets are a useful tool for planning an organization’s expenditures. Examples of types of budgets managers use are expense budgets, revenue budgets, cash budgets, and capital budgets.

5. **Contrast bureaucratic and decentralized control approaches.**

An organization’s approaches to quality are based on its basic philosophy of control. With many organizations moving toward participation and employee empowerment, a choice must be made between the traditional bureaucratic control and contemporary decentralized approaches. Bureaucratic control is the use of rules, policies, hierarchy of authority, written documentation, reward systems, and other formal mechanisms to influence employee behavior and assess performance. Bureaucratic control relies on the cultural value of traditional top-down control and is implemented through the organization’s administrative system. Decentralized control represents cultural values almost the opposite of bureaucratic control. Decentralized control relies on social values, traditions, shared beliefs, and trust to foster compliance with organizational goals.

Employees are trusted, and managers believe employees are willing to perform correctly without extensive rules or supervision. Decentralized control is implemented through the corporate culture, peer groups, self-control, and employee selection and socialization.

6. **Describe the concept of total quality management (TQM) and major TQM techniques.**

Total quality management (TQM) is a philosophy of organization-wide commitment to continuous improvement, with the focus on teamwork, increasing customer satisfaction, and lowering costs. TQM works through horizontal collaboration across functions and departments and extends to include customers and suppliers. Teams of workers are trained and empowered to make decisions that help the organization achieve high standards of quality. This is a revolution in management thinking because quality control departments and formal control systems no longer have primary control responsibility. Quality control thus becomes part of the day-to-day business of every employee.
7. Identify current trends in financial control and discuss their impact on organizations.

Some of the major trends in controls include international quality standards, open-book management, economic value added (EVA) systems, and activity-based costing (ABC).

International Quality Standards - Many countries have endorsed a universal framework for quality assurance called ISO 9000, a set of international standards for quality management adopted in the late 1980s by more than 50 nations, including the United States. These standards set uniform guidelines defining what manufacturing and service organizations should do to ensure their products conform to high-quality requirements.

Economic Value Added (EVA) Systems - Hundreds of companies have set up economic value added (EVA) measurement systems as a new way to gauge financial performance. EVA is defined as a company’s net (after-tax) operating profit minus the cost of capital invested in the company’s tangible assets. Measuring performance in terms of EVA is intended to capture all the things a company can do to add value from its activities.

Market Value Added (MVA) adds another dimension because it measures the stock market’s estimate of the value of a company’s past and projected capital investment projects. A positive MVA usually goes hand-in-hand with a high EVA measurement.

Activity-Based Costing (ABC) - Identifies various activities needed to provide a product and determines the cost of each of those activities. ABC allocates costs across business processes; it provides a more accurate picture of the cost of various products and services. In addition, it enables managers to evaluate whether more costs go to activities that add value or to activities that do not add value.

8. Explain the value of open-book management and the balanced scorecard as new workplace approaches to control in a turbulent environment.

Open-Book Management allows employees to see for themselves – through charts, computer printouts, meetings, and so forth – the financial condition of the company. Open-book management also shows the individual employee how his or her job fits into the big picture and affects the financial future of the organization.

The balanced scorecard is a comprehensive management control system that balances traditional financial measures with operational measures relating to a company’s critical success factors. A balanced scorecard contains four major perspectives: financial performance, customer service, internal business processes, and the organization’s capacity for learning and growth.
Lecture Outline

Suggested Opening Remarks

The story of Gateway, Inc., at the beginning of the chapter demonstrates the importance of control. The control system at Gateway, developed based on the personal preferences of co-founder and CEO Ted Waitt, was too loose for the organization as it grew large and complex. The company’s losses began piling up and market share was declining. Waitt shifted toward a system emphasizing rigorous measurement and discipline to try to get Gateway back on track. At the company’s new Poway, California, headquarters, a 9 foot by 12 foot screen that is visible to all employees displays a running daily score comparing sales and costs with projected targets. Specific goals for all managers and departments are clearly defined, and their performance is regularly reviewed by Gateway’s top human resources executive. This new approach to performance measurement has led to the departure of several managers who consistently failed to meet goals or didn’t agree with action plans for correction.

After Gateway acquired eMachines, Waitt turned the CEO’s job over to eMachines head Wayne Inouye, who naturally takes a more disciplined approach to measurement and control than Waitt. In addition to monitoring costs, sales, and other financial metrics, the new system includes ways to measure customer service and satisfaction. Gateway is still struggling, and it’s too soon to tell if the more disciplined approach to measurement can save the company. However, focusing on specific targets has had a significant impact. For example, the first week Gateway began tracking customer service indicators, managers were hitting their performance targets only 60 percent of the time. Within a couple of weeks, the rate had increased to 98 percent. In the second quarter of 2004, Gateway also announced a better-than-expected increase in sales, indicating that performance in that area is improving as well.

I. THE MEANING OF CONTROL

➤ Why is control a critical issue facing every manager in every organization today?

Control, including quality control, also involves office productivity, such as improved customer service, elimination of bottlenecks, and reduction in paperwork mistakes.

A lack of effective control can seriously damage an organization’s health and threaten its future; consider Enron’s shocking collapse after being considered a model organization.

Organizational control is the systematic process through which managers regulate organizational activities to make them consistent with the expectations established in plans, targets, and standards of performance.

To effectively control an organization, managers (or workers) require information about performance standards, actual performance, as well as actions to correct deviations from the standard.
MANAGER’S SHOP TALK

E-Commerce Metrics

Although different companies will use different standards and measurements, some common e-commerce metrics have emerged.

- Conversion rate. Conversion means the moment a customer buys, signs up, or subscribes.
- Clickstream. An analysis of customer behavior by seeing where people enter a site.
- Retention or customer loyalty. Companies want people to buy again and again.
- Site Performance. How the site performs, including how the time to load a page.

Discussion Question #1: Why is it important for managers to understand the process of organizational control?

Notes

II. ORGANIZATIONAL CONTROL FOCUS

The organization exists around a production process, and control can focus on events before, during, or after the production process.

These three types of control are formally called feedforward, concurrent, and feedback.

A. Feedforward Control

Feedforward control is anticipatory and attempts to identify and prevent deviations before they occur.

Also called preliminary or preventive control, the focus is on human, material, and financial resources that flow into the organization.

The purpose is to ensure that input quality is sufficiently high to prevent problems when the organization performs its tasks.

Another type of feedforward control is forecasting trends in the environment and managing risk.

B. Concurrent Control

Concurrent control monitors ongoing employee activities to ensure that they are consistent with performance standards.

Concurrent control assesses current work activities.

It relies on performance standards and includes rules and regulations for guiding employee tasks; it includes self-control imposed on behavior because of values.
C. Feedback Control

*Feedback control* focuses on the organizations outputs; also called *postaction* or *output control*.

Budgeting is a form of feedback control because managers monitor whether they have operated within their budget targets and make adjustments accordingly.

**Discussion Question #2:** How might a public school system use feedforward control to identify the best candidates for its teaching positions?

III. FEEDBACK CONTROL MODEL

> What is the importance of the feedback control model?

All well-designed control systems involve the use of feedback to determine whether performance meets established standards.

A. Steps of Feedback Control

Managers set up control systems that consist of four key steps:

1. **Establish standards of Performance**

   Within the organization’s overall strategic plan, managers define goals for organizational departments in specific, operational terms.

   These include a *standard of performance* against which to compare organizational activities.

   To effectively reward employees for the achievement of standards, managers need clear standards that reflect activities that contribute to the organization’s strategy.

   Standards should be defined clearly and precisely so employees know what they need to do and can determine whether their activities are on target.

2. **Measure Actual Performance**

   Most organizations prepare formal reports of quantitative performance measurements that managers review daily, weekly, or monthly.

   These measurements should be related to the standards set in the first step of the control process; managers do not rely exclusively on quantitative measurements.

   Managers observe for themselves whether employees are participating in decision making and have opportunities to add to and share their knowledge.

3. **Compare Performance to Standards**
The third step in the control process compares actual activities to performance standards.

When performance deviates from a standard, managers must interpret the deviation; they must dig beneath the surface and find the cause of the problem.

Effective management control involves subjective judgment and employee discussions, as well as objective analysis of performance data.

4. Take Corrective Action

Managers also determine what changes are necessary; managers may encourage employees to work harder, redesign the production process, or fire employees.

Managers in a participative control approach collaborate with employees to determine the corrective action necessary.

Managers may take corrective action to change performance standards; performance standards may need to be altered to make them realistic and provide motivation.

The online auction company eBay provides a good illustration of the feedback control model.

Discussion Question #4:
What standards of performance has your professor established for this class? How will your actual performance be measured? How will your performance be compared to the standards? Do you think the standards and methods of measurement are fair? Why or why not?

Notes

B. Application to Budgeting

Budgetary control sets targets for an organization’s expenditures, monitors results, compare them to the budget, and makes changes as needed.

As a control device, budgets are reports that list planned and actual expenditures for cash, assets, raw materials, salaries, and other resources.

Budget reports usually list the variance between the budgeted and actual amounts for each item.

A budget is created for every division or department within an organization so long as it performs a distinct project, program, or function.

The fundamental unit of analysis for a budget control system is called a responsibility center.

A responsibility center is any organizational department or unit under the supervision of a single person who is responsible for its activity.

The manager of each unit has budget “responsibility.”
Types of budgets managers use include expense budgets, revenue budgets, and capital budgets.

1. Expense Budget

An expense budget includes anticipated and actual expenses for each responsibility center and for the total organization.

An expense budget may show all expenses or focus on a particular category such as materials or research and development expenses.

When actual expenses exceed budgeted amounts, the difference signals the need for managers to identify whether a problem exists and if so, take action.

2. Revenue Budget

A revenue budget lists forecasted and actual revenues of the organization.

Revenues below the budgeted amount signal a need to investigate the problem to see whether the organization can improve revenues.

Revenues above the budget require determining whether the organization can obtain the resources to meet the higher demand for products.

3. Cash Budget

Cash budgets estimate receipts and expenditures of money on a daily or weekly basis to ensure that an organization has sufficient cash to meet its obligations.

The cash budget shows the level of funds flowing through the organization and the nature of cash disbursements.

If the cash budget shows that the firm has more cash than necessary to meet its needs, the company can invest the excess funds.

If the cash budget shows a payroll expense that exceeds the amount of money in the bank, the organization must borrow cash to meet the payroll.

4. Capital budgets

Capital budgets list planned investments in major assets such as buildings, trucks, and heavy machinery, often involving expenditures over more than a year.

A capital budget is necessary to plan the impact of these expenditures on cash flow and profitability.

Budgeting is an important part of organizational planning and control. Many companies use:

- Top-down budgeting: Budgeted amounts for the coming year are imposed on middle and lower-level managers.

- Bottom-up budgeting: Lower-level managers anticipate their departments’ resource needs and pass them up to top management for approval.

Discussion Question #3: What are some examples of feedback control that might be used in a family-style restaurant? In a large hospital?
IV. FINANCIAL CONTROL

➢ Why is financial control so important?

Managers need to watch how well the organization is performing financially.

Financial controls tell whether the organization is on sound financial footing, but they can be useful indicators of other kinds of performance problems.

A. Financial Statements

Financial Statements provide the basic information used for financial control of an organization.

There are two major financial statements—the balance sheet and the income statement—are the starting points for financial control.

• The balance sheet shows the firm’s financial position with respect to assets and liabilities at a specific point in time.

The balance provides three types of information: assets are what the company owns, and they include current assets and fixed assets.

Liabilities are the firm’s debts, including both current debt and long-term debt.

Owners’ equity is the difference between assets and liabilities and is the company’s net worth in stock and retained earnings.

Exhibit 19.4

• The income statement, also called a profit-and-loss statement or “P & L,” summarizes the firm’s financial performance for a given time interval, usually one year.

The bottom line indicates the net income-profit or loss-for the given time period.

Discussion Question #7: What types of analysis can managers perform to help them diagnose a company’s financial condition? How can a review of financial statements help managers diagnose other kinds of performance problems as well?

B. Financial Analysis: Interpreting the Numbers

Financial analysis allows managers to be able to evaluate financial reports that compare their organization’s performance with earlier data or industry norms.
The most common financial analysis focuses on ratios, which express the relationships between performance indicators such as profits and assets, sales, and inventory. Managers decide which ratios reveal the most important relationships for their business.

1. Liquidity Ratios

   *Liquidity ratios* indicate an organization’s ability to meet its current debt obligations.

   The *current ratio* (current assets divided by current liabilities) tells whether there are sufficient assets to convert into cash to pay off debts, if needed.

2. Activity Ratios

   *Activity ratios* indicate an organization’s ability to meet its current debt obligations.

   *Inventory turnover* is calculated by dividing the total sales by average inventory; this tells how many times the inventory is used to meet the sales figure.

   The *conversion ratio* is purchase orders divided by customer inquiries; this ration indicates effectiveness in converting inquiries into sales.

3. Profitability Ratios

   *Profitability ratios* state profits relative to a source of profits, such as sales or assets.

   The *profit margin on sales* is calculated as net income divided by total sales; the *gross margin* is the gross (before-tax) profit divided by total sales.

   Another profitability measure is *return on total assets (ROA)*, a percentage representing company earnings from assets, computed as net income divided by total assets.

   ROA is a valuable yardstick for comparing a company’s ability to generate earnings with other investment opportunities.

   A company should earn more by using its assets than it could by putting its investment in the bank.

4. Leverage-ratios

   *Leverage-ratios* refer to funding activities with borrowed money; a company uses leverage to make its assets produce more than they could on their own.

   Too much borrowing can put the organization at risk such that it will be unable to keep up with repayment of its debt.

   Managers track the *debt ratio*, or total debt divided by total assets, to make sure that it does not exceed a level they consider acceptable.

**Discussion Question #5:** *What is the difference between budgeting and financial analysis? Why is each type of control important to a company?*
Tesco, Britain’s number-one supermarket chain, recently achieved something extraordinary for a retailer—being named Britain’s Most Admired Company. Tesco is so well-managed that it earned as much profit in one recent year as its four biggest competitors combined. When the company launched a dot-com division, managers focused on ensuring profitability. Tesco implemented strict financial controls by launching the Internet business from within the chain’s current grocery stores. By maintaining strict control over operating costs, checking and rechecking the math to make sure the company was headed in the right direction, Tesco has slowly rolled out online service all across Britain.

V. THE CHANGING PHILOSOPHY OF CONTROL

Exhibit 19.6

Bureaucratic control and decentralized control represent different philosophies of corporate culture.

Bureaucratic control involves monitoring and influencing employee behavior through rules, policies, hierarchy of authority, written documentation, and reward systems.

Bureaucratic methods define explicit rules, policies, and procedures for employee behavior; control relies on: centralized authority, the formal hierarchy, close personal supervision.

Responsibility for quality control rests with quality control inspectors and supervisors rather than with employees.

Bureaucratic control techniques can enhance organizational efficiency and effectiveness.

Decentralized control relies on cultural values, traditions, shared beliefs, trust to foster compliance with organizational goals

Decentralized control is based on values and assumptions with rules and procedures used only when necessary.

The organization places great emphasis on the selection and socialization of employees to ensure that workers have the values needed to influence behavior which meets goals.

With decentralized control, power is more dispersed and based on knowledge and experience as much as position.

Everyone is involved in quality control on an ongoing basis; job descriptions are generally results-based.
Managers use not only extrinsic rewards such as pay, but also the intrinsic rewards of meaningful work and the opportunity to learn and grow.

Employees participate in a wide range of areas, including: setting goals, determining standards of performance, governing quality, and designing control systems.

With decentralized control, the culture is adaptive, and managers recognize the importance of culture for uniting individual, team, and organizational goals for greater overall control.

**Discussion Question #6:** In what ways could a university benefit from bureaucratic control? In what ways might it benefit from decentralized control? Overall, which approach do you think would be best at your college or university? Why?

**Notes**

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**VI. TOTAL QUALITY MANAGEMENT (TQM)**

One popular approach based on decentralized control philosophy is total quality management (TQM).

*TQM* infuses quality throughout every activity in a company; TQM philosophy focuses on teamwork, increasing customer satisfaction, and lowering costs.

Organizations implement TQM by encouraging managers and employees to collaborate across functions and departments, as well as with customers and suppliers, to identify areas for improvement, no matter how small.

A. TQM Techniques

Most companies that have adopted TQM have incorporated quality circles, benchmarking, Six Sigma principles, and continuous improvement.

1. Quality Circles (QC)

   A *quality circle* is a group of six to twelve volunteer employees who meet regularly to discuss and solve problems affecting the quality of their work.

   They meet during work-hours to identify problems and find solutions because employees who do the job know how to improve performance.

   The reason for using quality circles is to push decision making to a level at which recommendations can be made by those who do the job.

2. Benchmarking

   *Benchmarking* is the continuous process of measuring products, services, and practices against the toughest competitors or those companies recognized as industry leaders.

   The key to successful benchmarking lies in analysis; a company must honestly analyze its current procedures and determine areas for improvement.

   A company carefully selects competitors worthy of copying and emulates their internal processes and procedures.
3. Six Sigma

*Six Sigma* is a highly ambitious quality standard that specifies a goal of no more than 3.4 defects per million parts.

Six Sigma has become a generic term for a quality control approach that takes nothing for granted and emphasizes higher quality and lower costs.

The discipline is based on DMAIC (Define, Measure, Analyze, Improve, and Control); this methodology provides a structured way for solving problems.

Effectively implementing Six Sigma requires a major commitment from top management because widespread change is required.

4. Reduced Cycle Time

*Cycle time* refers to the steps taken to complete a company process, such as teaching a class, publishing a textbook, or designing a new car.

The focus is on improved responsiveness and acceleration of activities into a shorter time.

Reduction in cycle time improves overall company performance as well as quality.

5. Continuous Improvement

*Continuous improvement* is the implementation of a large number of small, incremental improvements in all areas of the organization on an on-going basis.

All employees are expected to contribute by initiating changes in their own job activities; there is no end to the process.

Innovations can start simply, and employees can build on their success.

B. TQM Success Factors

Many organizational contingency factors influence the success of a TQM program.

Positive factors include:

- Tasks make high skill demands on employees.
- TQM enriches jobs and motivates employees.
- Problem solving skills are improved.
- Participation and teamwork are used to tackle significant problems.
- Continuous improvement becomes a way of life.

The best illustration of a successful quality program is still the Japanese care company, Toyota; Toyota has a giant banner that says, “Good thinking means good products.”
Discussion Question #8: Why is benchmarking an important component of total quality management (TQM) programs? Do you believe a company could have a successful TQM program without using benchmarking?

Notes

VII. TRENDS IN QUALITY AND FINANCIAL CONTROL

Companies are responding to changing economic realities and global competition by reassessing organizational management and processes including control mechanisms.

A. International Quality Standards.

One impetus for total quality management in the United States is the increasing significance of the global economy. 

*ISO 9000* is a set of international standards for quality management systems established by the International Organization for Standardization in 1987 and revised in late 2000.

Hundreds of thousands of organizations in 150 countries have been certified to demonstrate their commitment to quality.

ISO 9000 has become the recognized standard for evaluating and comparing companies on a global basis, and more U.S. companies are feeling the pressure to participate in order to remain competitive in international markets.

Many countries and companies require ISO 9000 certification before they will do business with an organization.

B. New Financial Control Systems

Managers in many organizations are using systems such as economic value added, market value added, and activity based costing to provide effective control.

1. Economic Value Added (EVA) Systems.

*Economic value added* measurement systems can be defined as a company’s net (after-tax) operating profit minus the cost of capital invested in the company’s tangible assets.

Measuring performance in terms of EVA is intended to capture all the things to add value to activities, such as efficiency and customer satisfaction.

Each job, department, process, or project in the organization is measured by the value added; EVA can help managers make more cost-effective decisions.


*Market value added* measure the stock market’s estimate of the value of a company’s past and projected capital investment projects.
If market value (the value of stock plus debt) is greater than the capital invested, the MVA is positive, an increased value of the capital entrusted to it. A positive MVA usually goes hand-in-hand with a high EVA measurement. Microsoft ranked second in MVA but had a lower EVA rating than GE; this means that the stock market believes that Microsoft has greater opportunities for growth, which will increase EVA.

3. Activity-Based Costing (ABC).

Managers measure the cost of producing goods and services so they can be sure they are selling those products for more than the cost to produce them. Activity-based costing identifies various activities needed to provide a product and determines the cost of each of those activities. An ABC system might list the costs for processing orders, scheduling production, producing and shipping a product, and resolving associated problems. Because ABC allocates costs across business processes, it provides a more accurate picture of the cost of various products and services. It enables managers to evaluate whether more costs go to activities that add value (achieving high quality) or to activities that do not add value (paperwork).

Discussion Question #9: How might activity-based costing provide better financial control tools for managers of a company such as Kellogg that produces numerous food products?

Notes

VII. CONTROL SYSTEMS FOR TURBULENT TIMES

➢ How have control methods changed for turbulent times?

Changing organizational structure and the resulting management methods that emphasize information sharing, employee participation, learning, and teamwork have led to some new approaches to control in today’s workplace.

Two significant aspects of control in the new workplace are open-book management and use of the balanced scoreboard.

A. Open-Book Management

Open-book management allows employees to see for themselves the financial condition of the company.

Open-book management shows the individual employee how his or her job fits into the big picture and affects the financial future of the organization.

Open-book management ties employee rewards to the company’s overall success.
The goal of open-book management is to get every employee thinking and acting like a business owner rather than like a hired hand.

**UNLOCKING CREATIE SOLUTIONS THROUGH PEOPLE**

*Semco’s Open Book Policy*

When Ricardo Semler took over from his father as head of the family business, Brazil’s Semco, he decided to manager based on a philosophy of “giving up control” by having faith in people and respect for their ideas. At Semco, he designed a business model in which employees have no set work schedules, no dress codes, no strict rules and regulations, and no employee manuals. Workers choose their own training and nobody approves expense accounts. About 30 percent of employees even set their own pay, and everyone in the company knows everyone else’s salary. All workers receive the company’s financial statements. The decentralized approach must be working. Semco has quadrupled its revenues and increased its workforce from 450 to 1,300 employees.

**Exhibit 19.9**

In some countries, managers have trouble running an open-book company because prevailing attitudes and standards foster confidentiality and secrecy.

Many business people in countries like China, Russia, and South Korea are not accustomed to publicly disclosing financial details.

The *Opacity Index* indicates the degree to which various countries are open regarding economic matters; the higher the rating, the more opaque, or hidden, the economy.

The U.S. has an opacity rating of 36, which is fairly low; in countries with higher ratings, financial figures are typically closely guarded and managers do not share information.

Globalization has an impact on economic opacity by encouraging a convergence toward global accounting standards that supports accurate collection, recording, and reporting of financial information.

**B. The Balanced Scorecard**

The *balanced scorecard* is a comprehensive management control system that balances traditional financial measures with operational measures relating to a company’s critical success factors.

A balanced scorecard contains four major perspectives:

- *Financial Performance* reflects a concern that the organization’s activities contribute to improving short- and long-term financial performance.
• *Customer service* indicators measure such things as how customers view the organization, as well as customer retention and satisfaction.

• *Internal business processes* focus on production and operating statistics.

• *Learning and growth* focuses on how well resources and human capital are being managed for the company’s future.

Managers focus on various elements of the scorecard to set targets, evaluate performance, and guide discussion about what further actions to take.

The balanced scorecard is not right for every organization; the simplicity of the system causes managers to underestimate the time and commitment needed.

**Discussion Question #10:** Why do you think today’s managers would want to use the balanced scorecard to measure and control organizational performance?

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C. New Workplace Concerns

Managers in today’s organizations face some difficult control issues; there is a move toward increasing control.

*Corporate governance* is a system of governing an organization so the interests of corporate owners are protected.

The financial reporting systems and the roles of boards of directors are being scrutinized in organizations around the world.

In the fast-moving environment, *undercontrol* can be a problem because managers can’t keep personal tabs on everything in a large, global organization.

Many indicted CEOs claimed that they were unaware of misconduct.

However, *overcontrol* can be an equally touchy situation; managers feel justified in monitoring e-mail to ensure that employees do their work, not write personal emails.

Yet, employees resent and feel demeaned by close monitoring that limits personal freedom; excessive control leads to demotivation, low morale, and lack of trust.

Good organizations depend on mutual trust and respect among managers and employees.

**Lecture Example File**

Ownership Thinking’s mission is to help businesses unleash their potential. The Ownership Thinking™ Management System will help employees:

Think like owners... through **financial training**.
Act like owners... through **strategic planning**.

Feel like owners... through **incentive programs**.

Innovate like owners... through **entrepreneurship**.

Perform like owners... through **leadership development**.

Ownership Thinking™ is an experienced licensee of The Great Game of Business® (GGOB) process. The company has helped hundreds of organizations to significantly improve earnings by creating businesses made up of business people from the shop floor to the front office who all:

- Understand how their company makes money and how they contribute.
- Identify key indicators and create systems to forecast desired results in an environment of high visibility and accountability.
- Create incentive plans that are self-funding and drive the future opportunities of their organization.

**Answers To End-Of-Chapter Discussion Questions**

1. **Why is it important for managers to understand the process of organizational control?**

Organizational control is the systematic process of regulating organizational activities to make them consistent with the expectations established in plans, targets, and standards of performance. In a classic article on the control function, Douglas S. Sherwin summarizes this concept as follows: “The essence of control is action which adjusts operations to predetermined standards, and its basis is information in the heads of managers.” Thus, effectively controlling an organization requires information about performance standards and actual performance, as well as actions taken to correct any deviations from the standards. Managers need to decide what information is essential, how they will obtain that information (and share it with employees), and how they can and should respond to it.

2. **How might a public school system use feedforward control to identify the best candidates for its teaching positions?**

A public school system may use feedforward control to identify teaching candidates through their application, interviews, background and reference checks. Control that attempts to identify and prevent deviations before they occur is feedforward control. Sometimes called preliminary or preventive control, it focuses on human, material, and financial resources that flow into the organization. Its purpose is to ensure that input quality is high enough to prevent problems when the organization performs its tasks. Feedforward controls are evident in the selection and hiring of new employees. Organizations attempt to improve the likelihood that employees will perform up to standards by identifying the necessary skills and using tests and other
screening devices to hire people who have those skills. Feedforward control anticipates problems with its focus on inputs.

3. How might the manager of a family-style restaurant use concurrent controls to ensure that the restaurant is providing customers with the highest quality food and service? What feedback controls could be useful?

Control that monitors ongoing employee activities to ensure they are consistent with quality standards is called concurrent control. Concurrent control assesses current work activities, relies on performance standards, and includes rules and regulations for guiding employee tasks and behaviors. Its intent is to ensure that work activities produce the correct results. A manager of a restaurant would use concurrent controls in the preparation and distribution of food entrees. Restaurant employees could monitor the measurements; if they see that quality is not met in food preparation, they would signal the appropriate person that a problem is occurring. Technology advancements are adding to the possibilities for concurrent control in services as well.

4. What standards of performance has your professor established for this class? How will your actual performance be measured? How will your performance be compared to the standards? Do you think the standards and methods of measurement are fair? Why or why not?

Performance standards are normally set forth by the professor in determining the grading procedure of a course syllabus. An example could be 90-100 A’s, 80-89 B’s, 70-79 C’s, etc. The actual performance is determined through student test grades, case method analysis, and research papers. The teacher can compare performance against the standards when tests, case method analysis, and research papers are evaluated. When these results are given back to students, corrective action can be forthcoming based on the performance when compared against the standard. Student responses may vary based on their assessment of the performance standard against their individual performance in the classroom.

5. What is the difference between budgeting and financial analysis? Why is each type of control important to a company?

Budgets are a useful tool for planning an organization’s expenditures. When managers use budgets to ensure they are meeting their plans, budgets also are a control technique. As a control device, budgets are reports that list planned and actual expenditures for cash, assets, raw materials, salaries, and other resources. In addition, budget reports usually list the variance between the budgeted and actual amounts for each item. Managers need to be able to evaluate financial reports that compare their organization’s performance with earlier data or industry norms. These comparisons enable them to see whether the organization is improving and whether it is competitive with others in the industry. The most common financial analysis focuses on ratios, statistics that express the relationships between performance indicators such as profits and assets, sales and inventory. Some are financial ratios, which are measures of an organization’s liquidity, profitability, and leverage. These
are among the most common ratios, but many measures are used. Managers decide which ratios reveal the most important relationships for their business. Each type of control is important to a company because of the data being provided. This type of financial information is important to permit improved planning and control of the firm’s financial resources. Budgets are an excellent financial control in regards to planning and control of the firm’s resources. Ratio analysis is important because of the financial data being generated to make better financial decisions.

6. *Imagine that you are going to be the manager of a new Wal-Mart being built in your area. What items might be listed in your capital budget? What items might be listed in your expense budget?*

A manager of a new Wal-Mart store is concerned with capital budgeting and expense budgets. A capital budget lists planned investments in major assets such as buildings, trucks, and heavy machinery, often involving expenditures over more than a year. Capital expenditures not only have a large impact on future expenses, they are investments designed to enhance profits. An expense budget includes anticipated and actual expenses for each responsibility center and for the total organization. An expense budget may show all types of expenses or may focus on a particular category, such as materials, research and development, advertising, utilities, wages and salary, selling, and administrative expenses. When actual expenses exceed budgeted amounts, the difference signals the need for managers to identify whether a problem exists. The difference may arise from inefficiency, or expenses may be higher because the organization’s sales are growing faster than anticipated. Conversely, expenses below budget may signal exceptional efficiency or failure to meet some other standards, such as a desired level of sales or quality of service. Either way, expense budgets can help identify the need for further investigation but do not substitute for it.

7. *In what ways could a university benefit from bureaucratic control? In what ways might it benefit from decentralized control? Overall, which approach do you think would be best at your college or university? Why?*

Bureaucratic control involves monitoring and influencing employee behavior through extensive use or rules, policies, hierarchy of authority, written documentation, reward systems, and other formal mechanisms. With bureaucratic control, the organizational culture is somewhat rigid, and managers do not consider culture a useful means of controlling employees and the organization. Technology often is used to control the flow and pace of work or to monitor employees, such as by measuring how long employees spend on phone calls or how many keystrokes they make at the computer. Bureaucratic control techniques can enhance organizational efficiency and effectiveness. Many employees appreciate a system that clarifies what is expected of them, and they may be motivated by challenging, but achievable, goals. The university may benefit with a decentralized control by delegating downward to the closest point of action where the control tool can be applied. A decentralized control is permitting lower level employees to take corrective action when there is deviation from the planned performance against the standard. At this college, both bureaucratic and decentralized controls would be
utilized. Bureaucratic controls would be used to reassure plans were implemented and achieved. Decentralized controls would also be utilized to delegate to administrators and faculty the opportunity to take corrective action where planned performance deviates from the standard.

8. If you were managing a local video rental store, which company would you choose to benchmark one aspect of your store’s performance against? Why?

Student answers may vary, however one could choose BlockBuster Video. As a manager of a local video rental store, a benchmark such as market share or sales revenue per square foot could be analyzed. The rationale in selecting BlockBuster is because it is a national franchise and it has a large market share and generates high sales volume per square foot in their retail outlets.

9. Would you like to work for a company that uses open-book management? Would you like to be a manager in the company? Why or why not?

Most students would prefer to work for a firm using open-book management. The rationale would be that open-book management allows employees to see for themselves—through charts, computer printouts, meetings, and so forth—the financial condition of the company. Second, open-book management shows the individual employee how his or her job fits into the big picture and affects the financial future of the organization. Finally, open-book management ties employee rewards to the company’s overall success. The goal of open-book management is to get every employee thinking and acting like a business owner rather than like a hired hand. To get employees to think like owners, management provides them with the same information owners have: what money is coming in and where it is going. Open-book management helps employees appreciate why efficiency is important to the organization’s success.

10. Why is it important for an organization’s control system to be linked to its overall strategy?

It is important that organizational control should not have an exclusively inward focus on organizational activities. Control tends to encourage stability; that is, it encourages doing in the future what the organization has done well in the past. Yet the environment of the organization changes, and the control systems must also change to insure that new targets are established and new behaviors adopted. The point of Control Type III is that the internal control system should accommodate environmental factors by adapting to them. If the control system is not carefully linked to strategic planning, the target to which the organization is steered will not be consistent with the strategic needs of the external environment.

Teaching Note for Experiential Exercise

Is Your Budget in Control?
Student responses to “Is Your Budget in Control?” will vary. Students will range from having the most disciplined habits, to adequate habits, to the poorest budgeting habits. Suggestions are made on how to improve personal budgeting.

**Teaching Note for Ethical Dilemma**

**What Do You Do?**

Student responses to the three options available to Rhonda Gilchrist will vary. Most students will select Option 3 “Approach the owner of the agency and suggest other ways the agency might make a profit and deliver high-quality care, such as innovative ways to attract new clients to replace those that leave the roster in better health.”

**Surf the Net**

1. **Benchmarking.** Benefits of a TQM application of benchmarking would include The Benchmark Exchange. TBE is a very comprehensive and very user friendly electronic communication and information system designed specifically for use by individuals and organizations involved in Benchmarking and Process Improvement. TBE provides users with a comprehensive, centralized and specialized forum for all phases of Benchmarking. TBE is for veteran practitioners as well as those who are just beginning to discover the world of Benchmarking. TBE was designed by benchmarking practitioners for Benchmarking practitioners.

The benefits of subscribing to The Benchmark Exchange are countless.

- See what organizations have done to launch their Benchmarking programs.
- Conduct literature searches for your Benchmarking study.
- Learn what organizations should and shouldn't do and learn what can and can't be done.
- Solicit help from fellow members.
- Contact organizations with which you may want to conduct a Benchmarking study.
- Form a group with member organizations to share in a consortium study.
- Electronically exchange Benchmarking questionnaires and agendas with your partner(s).
- Talk to organizations that have already benchmarked what you would like to benchmark.

The reasons for a group or a company subscribing are to improve their performance and gain commitment from management and employees. Benchmarking provides the incentive or the goals to which companies can establish and strive to achieve.
This is an excellent motivating tool to the commitment of building excellence in the work environment.

2. **ISO 9000.** ISO 9000 is rapidly becoming the most popular quality standard in the world. Thousands of organizations have already adopted this important standard, and many more are in the process of doing so. ISO 9001 is for Organizations that Design, Produce, Install, and Service Products. ISO 9001 is a Quality Assurance Model. ISO 9002 is for Organizations that Produce, Install, and Service Products. ISO 9002 is a Quality Assurance Model made up of Quality System Requirements. ISO 9003 is for Organizations that Assure Quality through Final Inspection and Testing. ISO 9003 is a Quality Assurance Model made up of Quality System Requirements.

Student responses may vary in their selection of ISO 9000, ISO 9004, ISO 10011, and ISO 10012. The best known is the ISO 9000.

**Requirements.** ISO distinguishes between quality system requirements and product quality requirements. Quality system requirements are characteristics or properties that systemic elements should have. Product quality requirements are characteristics or properties that products (or services) should have.

**ISO distinguishes between four types of products:** hardware, software, processed materials, and services. Notice that a service is a product.

**The quality of your product depends on:**
- Whether you routinely update it to meet changing market requirements and opportunities.
- Whether you design into your product the characteristics the marketplace needs and wants.
- Whether every instance of your product precisely conforms to your product design.
- Whether you provide customer support throughout the life cycle of your product.

**All work is a process.**
- Every process is a transformation.
- Every process has inputs and outputs.
- Every process transforms inputs into outputs.

**An organization is a network of processes.**
- Organizations must identify, organize, and manage this network of processes.
- The link or interface between each process must be clearly defined and well managed.
Product quality depends on how well this network of processes works. Therefore this network must be routinely monitored and analyzed. Therefore the continuous improvement of this network must be a high priority.

A quality system is a network of processes. These processes must be well integrated and properly coordinated. The link or interface between each process must be clearly defined and well managed.

When evaluating a quality system process, you must ask:
Have you developed procedures to control this process.
Are the procedures that control this process both documented and well defined?
Are the procedures that define this process completely deployed and implemented?
Are the procedures that define this process able to generate the necessary results?

Quality systems are evaluated by:
Executive managers.
Quality auditors.
Internal auditors.
    First party auditors: your employees.
External auditors.
    Second party auditors: your customers.
    Third party auditors: independent bodies.

A process is documented by writing procedures.
Your quality system should be documented by writing procedures.
If you document your current quality system procedures, changes in quality are easier to detect and to measure because they can be compared with the way things were done in the past.

Documents provide objective evidence that:
A process has been defined.
Procedures have been approved.
Procedural changes are under control.

To begin there are basic assumptions to ISO 9000. Design, quality, and training will influence the quality of the product. Purchasing, management, technology, and work patterns influence the quality of the product. Resource levels, job description, planning methods, inspection and testing influence the quality of products. Reporting relationships, transportation services, policies and procedures, communication pattern, record keeping systems, service delivery, inventory control method, employee knowledge and skill, channels, and customers promote the highest level of quality. The impression one receives of the ISO 9000 certification is
extremely thorough and complete in the creation of quality standards at the highest level.

3. **The Economic Value Added (EVA) Systems.**

A.) Student responses will vary, unable to access the video portion. (Must have video card and head phones/speakers.)

B.) Student response will vary depending on the two countries selected.

As a parade of '90s management mantras flop or fade—remember Reengineering and right-sizing?—one Big Idea has not only survived but is captivating increasing numbers of pro-shareholder CEOs, aggressive money managers, and tough-minded analysts. The concept is economic value added, and all three groups are demanding that companies adopt it as their guiding principle. In a single, simple measure, EVA answers the most basic question in business: Is management creating or destroying wealth for stockholders? "Accounting benchmarks just don't do the job," says Robert Boldt, the senior investment officer at Calpers, the $135 billion pension fund.

"Only EVA gives a real picture of value creation. "Indeed, FORTUNE's annual list of the top wealth creators shows how outstanding EVA performance builds piles of market value added (MVA), or huge gains for shareholders. Put simply, EVA helped American companies vastly improve their management by sending them back to the basics. Far from being new, EVA, in effect, is one of the long-standing pillars of finance theory: Until a company posts a profit greater than its cost of capital, it's not making money for shareholders, no matter how good accounting earnings look.

Investors are obsessed with a company's ability to deliver year-over-year earnings growth, bidding up a firm's share price if this measure of performance is achieved. And when the focus of management becomes earnings growth at any cost - since executive compensation is increasingly based on a company's earnings per share - it often seems that it doesn't matter how much capital is consumed in the process. But when the cost of capital is so high that shareholder wealth is destroyed, rather than created, the company's share price has nowhere to go but down. For example, amid market of falling nickel prices, Inco Ltd. (N/TSE) appeared to do well when it squeaked out a small profit of US$75 million ($0.25 a share). However, the company's share price fell 40% to close the year at $24.30, and $3.2 billion of shareholder wealth was destroyed. After taking into account the total cost of its capital, Inco recorded a net loss of $505 million.

C.) Student response will vary depending on the category that is selected.

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**Case for Critical Analysis Solution**

**Lincoln Electric**
1. What types of control—feedforward, concurrent, or feedback—are illustrated in this case? Explain.

The types of control implemented at Lincoln Electric are feedforward, concurrent, and feedback control. Feedforward control is a preventative control, and the employees can implement this type of control through self-control. Managers and employees can generate a visionary process based on their experience by projecting to the future when utilizing this process, one can anticipate activities and controls that may be implemented. Premaintenance inspection before equipment malfunctions would be such a control. Concurrent controls are in place through quality applications. Employees who utilize concurrent controls can inspect and measure quality concurrently while production takes place in and throughout the plant. Feedback control is after-the-fact where the analysis is forthcoming and corrective action can be undertaken. Feedback controls are utilized through merit reviews, annual bonuses, and profit and loss statistics of the operation. Another feedback control is the finished product coming off the production line.

2. Based on what you’ve just read, what do you think makes the Lincoln System so successful?

The Lincoln Electric plant has been so successful because of money-motivating performance. Those who are willing to work hard and do any job required of them are able to earn extraordinary salaries, and it is unlikely they could earn as much in other jobs. Another reason for Lincoln’s success is that the management of the operation has financial controls in place to promote productivity and quality applications. Success is partly related to the values discussed in the case. The fact that pay for company executives, including the CEO, is also based on performance helps promote a sense of “fairness” as well. Try to draw students into a discussion of whether they would want to work in a place like Lincoln Electric.

3. What changes might Lincoln managers have to make to adapt their management system to overseas operations?

Lincoln Electric management must facilitate certain changes to bring success to their overseas operations. Management must develop a strategy that will fit into their global operation, recognizing that there are different philosophies, cultures, and financial controls needed in a foreign national country. Money will motivate individual performance in the United States, however it may not meet the needs of an individual in a foreign culture. Lincoln Electric offers ambitious employees the chance to make an almost unlimited amount of money. In some foreign cultures people place greater emphasis on family and social relationships.