

# Control

**Subject : Commerce**

**Lesson: Control**

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# Control

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# Control

## Learning Outcomes

After you have read this chapter, you should be able to

- Define control and identify its characteristics;
- Relate control and planning;
- Evaluate significance of control;
- Describe kinds of control;
- Explain the process of control;
- Recognize requirements of effective control system;
- Empathize with the behavioral aspects of managerial control; and
- Analyze modern control techniques.



# Control

## 25.0 Introduction

**Figure 25.1 Control**



**Source:**

<http://www.google.co.in/imgres?imgurl=http://images.clipartof.com/small/63515-Royalty-Free-RF-Clipart-Illustration-Of-An-Orange-Person-Controlling-Business-Men-On-Strings.jpg&imgrefurl=http://www.clipartof.com/details/clipart/63515.html&usq=E5HIMqkfnsq7TtrJrRuBP0nv2qc=&h=450&w=450&sz=53&hl=en&start=0&zoom=1&tbnid=YKJwNPifOL3RtM:&tbnh=136&tbnw=114&prev=/images%3Fq%3Dcontrolling%26hl%3Den%26sa%3DG%26biw%3D975%26bih%3D410%26gbv%3D2%26tbs%3Disch:1&itbs=1&iact=hc&vpx=304&vpy=74&dur=1107&hovh=225&hovw=225&tx=79&ty=164&ei=0qC9TJf4IoGSuwOd04Ua&oei=0qC9TJf4IoGSuwOd04Ua&esq=1&page=1&ndsp=9&ved=1t:429,r:5,s:0>

Even with the best laid out plans; well-designed organization structures, effective directions and well trained personnel, results may be a distant dream, if organizational activities are not controlled properly. Control is one of the important functions of management. It ensures the performance of planned activities and the achievement of pre-determined objectives of organization. Controlling also means checking the behavior of events and people and curbing undesirable tendencies to make people conform to certain norms and standards to ensure that what is planned is translated into results. The present chapter deals with significance, process of control, requisites of effective control system, its behavioral implications and evaluate some of the modern control techniques.

# Control

## 25.1 Concept of Control

<b>Value addition 25.1.1: Focus of the Section</b>
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<b>25.1 Concept of Control</b>
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This section begins with the importance of control and gives the definitions of the term control. The purpose is to familiarize the reader with the control which is the last component of the management process. This section spells out the characteristics of control, which is drawn out from the definitions given. You will notice how pervasive and dynamic this function is. We clearly bring up the relationship between planning and control. You will notice how worthless planning is without control and vice-a-versa. This is also presented through figure 25.2. Then we discuss in detail the significance of control. Notice its future potential and how it helps in keeping psychological check. Next we discuss the limitations of control as by its very nature, any control mechanism presents dilemma of too much versus too little.
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### 25.1.1 Definitions

Different authors have defined controlling as follows:

According to E.F.L Breach –

*"Control is a process of checking actual performance against the agreed standards or plans with a view to ensuring adequate progress and satisfactory performance."*

According to Koontz and Weihrich-

*"The managerial function of controlling is the measurement and correction of the performance in order to make sure that enterprise objectives and the plans devised to attain them are accomplished."*

According to Terry and Franklin-

*"Controlling is determining what is being accomplished- that is, evaluating the performance and, if necessary, applying corrective measures so that the performance takes place according to plans."*

Robert J. Mockler's definition of control points out the essential elements of the control process:

*"Management control is a systematic effort to set performance standards with planning objectives, to design information feedback systems, to compare actual performance with these predetermined standards, to determine whether there are any deviations and to measure their significance, and to take any action required to assure that all corporate resources are being used in the most effective and efficient way possible in achieving corporate objectives."*

Thus, the main function of the control process is to compare actual performance with predetermined standards and taking corrective measures to ensure achievement of objective according to the plans.

# Control

## **25.1.2 Characteristics of Control**

### **Pervasive Function**

Control is just another function of a manager just like planning, organizing, staffing and directing. Managers at all levels- top, middle and low control the planned activities.

### **Continuous Process**

Control is a continuous activity just like other functions of management. It is not after the event exercise which means she has to take action whenever something goes wrong. Control process continuously analyse objectives, policies, programs etc. Therefore, it very apt to say that it continues till the survival of the enterprise.

### **Forward Looking**

Control is linked with future and so is forward looking. A manager can take corrective action only for future operations. Control is usually preventive which takes care of minimizing wastages, losses and deviations from the standards.

### **Dynamic Process**

Control is a very flexible and dynamic process as it takes corrective actions which may, in turn, result in change in the performance of other managerial functions. As management handles such changes, it would not be wrong to say that managerial control is also dynamic.

### **Close Connection with Planning Function**

Control provides the basic for planning. Monitoring various activities means effective implementation of plans.

### **Positive Function**

Control measures actual performance and improves it by setting more profitable and attainable standards. It is not about acting when anything goes wrong but taking positive approach so that nothing goes wrong. It prevents deviations rather than corrects them. It is about achieving results.

**Control is People-oriented:** The main approach to managerial control is people-oriented. Control is exercised by the people to control various things and to take corrective measures.

### **Corrective Action**

Controlling prevents and corrects deviations. It takes corrective action before deviations damage the system. The causes of deviations need to be investigated and identified. A good system of control facilitates timely actions.

<b>Value addition 25.1.2: Check Your Progress</b>
<b>25.1 Concept of Control</b>
1. Which of the following is not associated with the term 'Control': (a) setting performance standards, (b) measuring actual performance, (c) scanning environmental influences, (d) measuring deviations, (e) taking corrective actions
2. Pick out the keyword that does not belong to this section. (a) Pervasive function (b) Dynamic process (c) Huge profits (d) Corrective action
<b>Answer:</b>
1. (c). Reason: Scanning the environmental influences is associated with the term 'Planning'. 2. (c). Reason: 'Huge Profits' can't be associated with Control.

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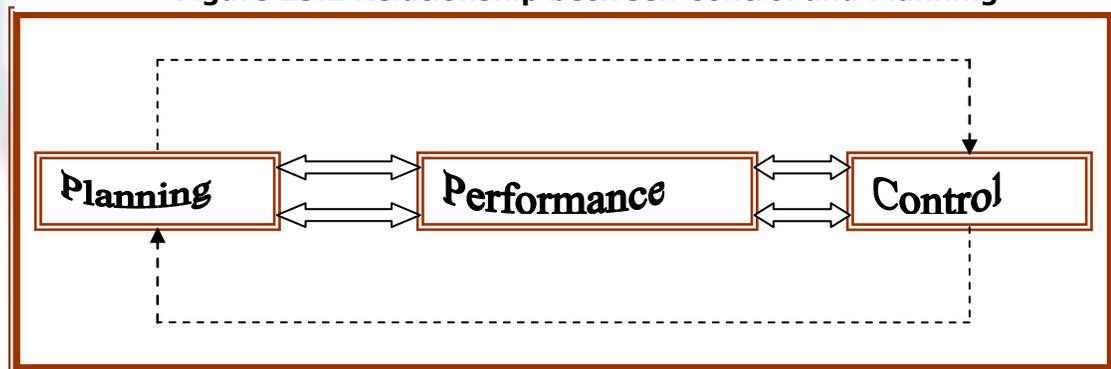
## **25.1.3 Relationship between Control and planning**

Planning and Control are closely related. Once a plan is formulated, we need control to measure progress, to discover deviations from plans and to suggest corrective actions. Therefore, an effective control system cannot be enforced without the existence of good plans. The definition of control, *a process which ensures actual performance to be in conformity with planned performance* draws important connection between planning and control. This is explained in the figure 25.2.

Control is always based on planning. Planning is the first managerial function of initiating action followed by organizing and directing people and resources to get the organizational work done whereas controlling is the last function which ensures that actions initiated have actually helped in the attainment of organizational goal.

Planning and control are perfect supplement to each other. Both concepts are interlinked to such extent that one cannot think of planning without control and vice versa. Even good plans may not bring the desired results if management lacks control. It is the control that ensures achievement of goals. A good plan will not bring any concrete result if the management is lacking in control. Control assumes that plans are laid down in advance against whom the actual performance is compared. If the objectives (standards) are not laid down in advance the manager will have no idea of what to control. The experience gained during the control process helps to improve the process of planning.

**Figure 25.2 Relationship between Control and Planning**



Generally we lay down strategic plans to achieve certain objectives which, in turn, require strategic control. Strategic control systematically monitors at various strategic control points and on the basis of this evaluation modifies the organization's strategy. Since control compares intended goals with actual performance, they provide learning opportunities, which in turn, forms the basis for organizational change. Finally, with the use of strategic control one gains knowledge not only about the organizational performance but also about the continuous changing environment by closely monitoring it.

# Control

## **25.1.4 Significance**

The importance of control can be understood with a simple contemplation. Suppose you are driving on road and there are no traffic signals to direct you. If the road is busy, you might end up with a trip to hospital as in all likelihood you will collide with another vehicle. For example, for a smooth and accident free traffic one needs to ensure that all road signals are working. Similarly, for the smooth functioning of an organization, management controls are required. Controlling is an important function of management. None of the managerial job can be completed without control. Once all the work is assigned by the manager, the next step is to make sure that they have been executed. He must exercise control over the actions so that his authority is properly delegated.

The benefits of control are following:

### **Coordination**

Control provides unity of direction to various organization activities. It ensures that action conforms to plans and there is complete synchronization between organization's physical, financial and human resources.

### **Corrective action**

It helps detect deviations and take corrective action at the right time. It allows savings of time, efforts and money which might result from not taking timely action.

### **Delegation of Authority**

It helps managers in the process of delegation. All the work can't be done by managers alone. However, the accountability vests with the managers. A well designed control system helps ensure this.

### **Facilitates Decentralization**

In a decentralized organization, decision-making is spread at various levels. Proper controlling facilitates this since managers are still accountable.

### **Identification of future potential**

Control system helps identify the reasons of deviations and this helps them to further explore the future potential so far not recognized. The corrective action may allow exploring the opportunities where organization can take action.

### **Psychological Implications**

Control process monitors the performance of subordinates and makes them more disciplined. Habitual dishonesty can also be cured by a good control system. It creates positive impact when good performance is awarded but poor performance is not punished.

# Control

<b>Value addition 25.1.3: Did you Know?</b>	
<b>The Controller and the Controlled</b>	
<b>CONTROLLER</b>	<b>CONTROL SUBJECT</b>
Operational Manager	Subordinate Units
Divisional or Senior Manager	Operational Manager
Corporate Manager	Divisional or Senior Manager
Internal Auditor	Operational Manager
External Auditor	Internal Auditor
External Auditor	Corporate Manager

**Source:**  
[www.post.queensu.ca/~grahama/FMTEXT/8.MANAGERIALCONTROL.ppt](http://www.post.queensu.ca/~grahama/FMTEXT/8.MANAGERIALCONTROL.ppt)

## **25.1.5 Limitations**

By its very nature, any control mechanism presents dilemma of too much versus too little. Too much control may adversely affect initiative and creativity of managers. Too little control may make the whole process of management ineffective.

### **Difficulties in measurement**

There are so many difficulties regarding the measurement of standards and techniques of evaluation. Some of the objectives may not be quantifiable at all. For example measuring employee morale is very difficult. The reliability and validity of measurement techniques may be questionable. It can be quite subjective at times.

### **Resistance to control**

It is human nature that nobody likes to be controlled. One may resist if one feels that it will affect his freedom.

### **Uncontrollable factors**

There are certain external factors such as government policies, technological changes, fashion changes, social changes, and so on.

### **Expensive process**

Control is quite an expensive process because it means incurring lot of cost on terms of efforts and money to observe and evaluate performance of subordinates.

### **Short-term view**

Managers often tend to rely on short-term implications and try to measure immediate results. The long-term impact of performance is often ignored.

### **Neglect of sub-ordinate's creativity**

Too much emphasis on results may discourage the creativity and initiatives of subordinates in the control process.

# Control

## Value addition 25.1.4: Pause and Think

### Just Who is the Controller?

The Key is to "In Control" not "Under Control" – who is in control here and who is under control?



Source:

[www.post.queensu.ca/~grahama/FMTEXT/8.MANAGERIALCONTROL.ppt](http://www.post.queensu.ca/~grahama/FMTEXT/8.MANAGERIALCONTROL.ppt)

## Value addition 25.1.5: Check Your Progress

### 25.1 Concept of Control

Arrange these in order:

- (a) Planning (b) Directing (c) Taking corrective action (d) Measuring (e) Organizing

**Answer:** (a) (e) (b) (d) (c)

## Value addition 25.1.6: Check Your Comprehension

### 25.1 Concept of Control

This one is not the limitation of exercising control:

- (a) Uncontrollable factors (b) Expensive process (c) Neglect of subordinate's creativity (d) Predictable behavior of workforce (e) Difficulty in measurement.

**Pick the option that best suits.**

**This section...**

<b>Completely understood</b> <input type="checkbox"/>	<b>Partially Understood</b> <input type="checkbox"/>	<b>Not understood</b> <input type="checkbox"/>
↓	↓	↓
<b>Move on to next section</b>	<b>Move on to next section but note that you need to revise this.</b>	<b>You need to re read this and discuss it with your batch mates.</b>

**Answer:** (d). Reason: Unpredictable behavior can be the limitation in exercising control.

# Control

<b>Value addition 25.1.7: Test Yourself</b>
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<b>25.1 Concept of Control</b>
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- |  |
|--|
| <ol style="list-style-type: none"><li>1. Explain in brief how control is related to planning.</li><li>2. What is the significance of control?</li><li>3. What are the difficulties in exercising control?</li><li>4. Pickup 5 keywords that describe limitations of Control functions.</li></ol> |
|--|

## 25.2 Kinds, Process and Effectiveness of Control

<b>Value addition 25.2.1: Focus of the Section</b>
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<b>25.2 Kinds, Process and Effectiveness of Control</b>
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This section very briefly makes you aware of the kinds of control according to the timings in which they are exercised. Notice the advantages and disadvantages of each of these three kinds of control. Then we move on to discuss the process of control. Follow the steps laid down one by one. This is also depicted through the figure 25.3. Notice how important feedback is at each level whether the set standard of performance is met or not. After making you aware of the process of control, we move on to discuss the requirements/ principles of effective control system. Read carefully to understand the terms: principles, control by exception and control at critical points.
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### 25.2.1 Kinds of Control

There are three kinds of control, which is also related to timing of control. These are as follows:

- (1) After the event takes place: Feedback control or Post control
- (2) As the events take place: Concurrent control or Real time control
- (3) Before the events take place: Feed-forward control or Pre control

#### **Feedback control:**

The first type of control focuses mainly on the outputs of the organization when transformation process is complete. Sometimes it is called post-action or output control. Under certain circumstances, feedback seems the only viable type of control available. A common example is that of Air-conditioning system, where the cooling is activated when the present level of temperature exceeds the set level.

The output control has two advantages over feed-forward and concurrent control. First, managers can easily ascertain how effective their planning efforts were. If the result indicates little variance between standard and actual performance, it is clearly evidence that planning was generally on target.

But on the other hand, if the deviation is great, a manager can use this information while formulating new plans to make them more effective. Second, this type of control can boost employees' motivation.

When feed-forward and concurrent controls are too costly or not feasible, feedback control is often used.

The major drawback of this type of control is that, by the time the manager realizes that there is some significant problem the damage is already done. But despite this limitation, for many activities, feedback control fulfils a number of important functions.

#### **Concurrent Control**

Concurrent control takes place while an activity is in progress. It regulates the ongoing activities that are part of transformation process to ensure that they conform to

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organizational standards. It is designed to ensure that employee efforts produce the correct results.

Since it regulates the ongoing tasks, it necessitates a thorough understanding of the specific tasks involved and their relationship to the desired end product.

This has been made possible with the use of computer and electronic system. The information so gathered is called real-time information. For example, Airlines get the information about seat availability by entering a flight number, trip segment say New Delhi to London and date into a memory system. This is of immense importance to managers as real-time information is seen as getting real-time control.

Concurrent control sometimes is called yes-no or steering control, because it often involves checkpoints at which decisions are taken about whether to continue progress, take corrective action, or stop work altogether on products and services. Steering controls are routine controls based on predetermined criteria or rules. Yes/no control means that everything is clearly well laid out, without room for confusion.

Drawback of this control is that perhaps it doesn't make possible real-time control as the analysis of deviations is a time consuming task.

## **Feed-forward Control**

The control must be directed towards the future if it is to be effective. Managers need a system that will tell them, in time to take a corrective action that problems will occur if they do not do something about them now.

Feed-forward control primarily focuses on the regulation of human, material, and financial resources (inputs) to ensure that they meet the standards necessary for the completion of transformation process.

These types of control are desirable because they allow management to prevent problems at an earlier stage rather than having to cure them later. Unfortunately, these controls require accurate and timely information, which is often difficult to develop. Therefore, it is sometimes called preliminary control, pre-control, preventive control, or steering control.

For example, a motorist, who wishes to maintain a constant speed in going up a hill, would not usually wait for a speedometer to signal a drop in speed before pressing the accelerator. Instead, knowing that the hill represents a disturbing variable in the system, the driver would correct this by pressing the accelerator before speed fall.

Clearly, the pre-control or feed-forward control is superior to the post control and concurrent control to the extent that deviations are not allowed to take place and the organization remains pro active instead of reacting to events after they occur or as they occur. At the same time feed-forward control also requires monitoring of output because there is no certainty that the final outputs are the desired ones.

The drawback of this control is that it is quite expensive to install and administer. Besides, all systems may not support feed-forward controls.

There is yet another classification of controls. According to this classification, the three control approaches regarding the mechanisms that managers use to implement controls are market control, bureaucratic control, and clan control. Management control and operational control are yet other controls.

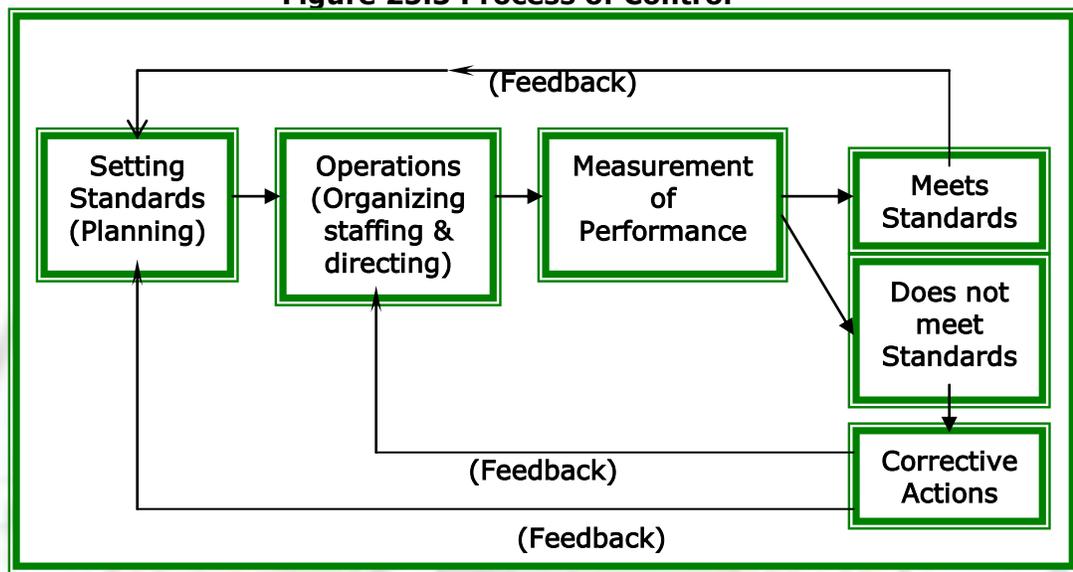
<b>Value addition 25.2.2: Did You Know?</b>
<b>25.2 Kinds, Process and Effectiveness of Control</b>
<b>Cybernetic Control System:</b> This type of control is self-contained in its performance, monitoring and correction capabilities (thermostat). Generally, the control process practiced in organizations is not cybernetic, but it follows similar principles.
<b>Source:</b> <a href="http://www.authorstream.com/Presentation/ankush85-212313-controlling-management-function-control-mba-education-ppt-powerpoint">http://www.authorstream.com/Presentation/ankush85-212313-controlling-management-function-control-mba-education-ppt-powerpoint</a>

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## **25.2.2 The Process of Control**

As has been given in the definition by Robert J. Mockler, the basic control process involves following steps, first, setting of Standards; second, measurement of Performance; third, comparing performance with the standards; and Fourth, taking corrective Action. This process is shown in figure 25.3.

**Figure 25.3 Process of Control**



### **Setting of Standards**

The first step in control process is setting of setting of standards. This provides criteria or benchmarks for measurement of performance. These standards should be preferably expressed in quantitative terms. The standard setting process is closely linked to the planning process. Standard should be expressed in such a way that concerned employees are able to understand them easily. But some of the standards can't be measured in quantitative terms like employee honesty, loyalty etc.

### **Measurement of Performance**

The next step is to measure actual performance. Without having information about the actual performance, a manger cannot exercise control. It is the actual performance, which is to be compared with the standards of performance to decide about further action. It is necessary to understand how this measurement takes place. The information system is the key element in this exercise. This is done through accounting, reporting and communication system.

The management should be careful while measuring the performance. Instead of measuring performance on guesswork, management should compare it with standards. Performance can be measured both in quantitive and qualitative terms. The quantitative measurement is done when standards are set in numerical terms. In other cases the performance may be measured in qualitative terms. In case of industrial relations manager, performance can be measured in terms of workers' attitude towards workers, morale, and frequency of strikes. Employees' attitude and morale can be measured qualitatively.

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## **Performance Appraisal**

In the control process, the next step is the appraisal of performance with predetermined standards. It is quite easy when it is done in quantitative terms as in case of production and marketing. Where results are intangible and of qualitative nature, direct personal observation, and inspection are the ways can be used for performance appraisal. Broadly, the following three situations may arise:

1. The actual performance matches the budgeted performance.
2. The actual performance deviates positively over the budgeted performance.
3. The actual performance deviates.

The first situation is ideal but not realistic. In practice, the actual performance rarely matches the budgeted performance.

The second situation is welcome as it is indication of superior performance. But if it happens repeatedly, then the validity of standards need to be checked. In the figure, it is shown by getting a feedback from this analysis of standards.

The third type of situation is alarming as it indicates a shortfall in achievement. The manager needs to pinpoint the areas where performance is below standard and analyze the cases whether it is at the stage of setting standards or at organizing, staffing or direction level.

All deviations don't need action. The deviations that are high in third situation need to be brought to the notice of management. This is also known "management by exception".

## **Taking corrective action**

The last step in the control process is taking corrective action so that deviations do not occur again and the objectives of organization are accomplished. This means management might take certain decisions like replanting or redrawing of standards, reassignment or reclassification of duties. It may also necessitate reforming the process of employee selection and training. This may in turn require change in all other managerial functions. Redefinition of objectives, however takes us back full circle to the start of strategy formulation process.

The management must avoid two possible mistakes. One is taking unnecessary action where it is not required and the other is not taking action where it is required. A good control system should provide some basis to help the manager in estimating the risk of making either of these types of errors.

## **25.2.3 Requirements/ Principles of Effective Control System**

Every efficient manager wants to have an effective system of control to make sure that results conform to plans. As the managers as a person and the specific task may be different, controls need to be designed to suit them. Though the basic process may be same, the actual system requires special design.

**Future Oriented:** The system should be such that corrective action doesn't allow repetition of error. Mistakes should be corrected and not repeated.

**Objective oriented:** First clear objective should be laid down. The control system must be directed towards the potential or actual deviation from plans at the early stage to allow corrective action.

**Responsibility for Control:** Responsibility for control should rest in the manager charged with the implementation of plans. If a manager is directly responsible in this process, the less will be need for indirect control.

**Economical:** It is costly to institute a control system. It must be ensured that costs are kept within limits. It is not necessary that an expensive control system will always be more effective.

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**Control by exception:** This means only material deviations from standards, whether positive or negative should be controlled. If all deviations are controlled, then it tends to take all the attention in unnecessary work. The more important deviations need to be monitored. Performances which are by and large within the permissible limits with minor deviations need not be brought to manager's attention. Controls that primarily focus on exceptions from planned performance allow managers to get benefit from time-honored exception principle. The idea behind principle of exception is 'no news is good news.' If there is nothing to report, the presumption is that the system is working alright.

It is very important to design controls according to the needs for efficiency and effectiveness and make sure that they are tailored to point up exceptions.

The system of control by exception is a system of identification and communication that signals the manager when needed.

**Control at critical points:** Sometimes it is not enough to look at exceptions only. Some of the deviations may not affect much while others may affect to a great extent. Therefore, controls are exercised where failures can be suicidal for the survival of the organization or where costs beyond a point would bring losses. These critical points are also called key result areas, critical points, key success factors, or strategic points. All the areas of an organization's operations that affect the success of its key operations are included while determining key points. A manager needs to understand the whole dynamics of control system to identify the critical points to design the appropriate standards for performance. For example, a manager may be worried if the cost of labor deviated from the budget by 5 percent but might remain unconcerned if the cost of stationery deviated from the budget by 20 percent.

Hence, the exception principle should be accompanied by the principle of critical point control.

**Individual-oriented:** Controls must be tailored to individual managers. If they are not of the type a manager will understand, and then they are of no help. What they can't understand can neither be trusted nor used.

**Suitable to Organization culture:** Any control system should fit the organizational work culture. For example, in an organization where people work in liberal environment, a tight system of control may straight away fail. On the other hand, if subordinates are allowed to participate in decision-making process, a permissive control system can't be a good choice.

**Flexible:** Business operates in the changing environment. The control system should be adjusting enough to incorporate this change. The impact of change in performance should be incorporated.

**Accuracy:** Information should be available in time. Effective control should provide information which is accurate, useful, reliable, valid and consistent.

**Objective standards:** The control technique should be based on objective, accurate and suitable standards. Its measurements should be simple and verifiable.

**Appropriate action:** It is worth having control system, if the deviations are corrected through appropriate action of planning, organizing, staffing and communicating it in the whole process.

There is no use of developing control mechanism if no action is to be taken afterwards. It is imperative that the top managers cannot carry out all the functions of controlling in detail. They can delegate a part of it to the middle level and line managers. They should report only the significant matters to the top management.

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## Value addition 25.2.3: Check Your Progress

### 25.2 Kinds, Process and Effectiveness of Control

1. State True or False: Concurrent control is based on past information.
2. One of the following is not the benefit of control:
  - (a) Control provides unity of direction to various organization activities.
  - (b) Proper controlling facilitates decentralization.
  - (c) A well designed control system helps ensuring raw authority of manager
  - (d) It keeps the subordinates under check and brings discipline among them.

**Answer:** 1. False. Reason: Concurrent control takes place while an activity is in progress. Feedback control is based on past information.

2. (c). Reason: It helps ensuring flexibility. Controls must be tailored to individual managers.

## Value addition 25.2.4: Check Your Comprehension

### 25.2 Kinds, Process and Effectiveness of Control

1. Arrange following elements of control process in sequence:
  - (a) Taking corrective Action
  - (b) Comparing performance with the standards
  - (c) Measurement of Performance
  - (d) Setting of Standards.
2. Match the following columns:

Column A	Column B
(a) A hunter aiming ahead of a duck's flight to correct for the time lag between a shot and a hoped-for hit is example of	(i) Feed-back control
(b) Department stores transmitting every data on sale to a central data storage facility is example of	(ii) Feed-forward Control
(c) The house thermostat is a system of	(iii) Concurrent control

**Pick the option that best suits.**

**This section...**

<b>Completely understood</b> <input type="checkbox"/>	<b>Partially Understood</b> <input type="checkbox"/>	<b>Not understood</b> <input type="checkbox"/>
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<b>Move on to next section</b>	<b>Move on to next section but note that you need to revise this.</b>	<b>You need to re read this and discuss it with your batch mates.</b>
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**Answer:** 1. (d), (c), (b), (a).

2. (a)-(ii), (b)- (iii), (c)- (i)

## Value addition 25.2.5: Test Yourself

### Kinds, Process and Effectiveness of Control

1. Write notes on Feed-forward, concurrent and feedback control.
2. Give an example of each of these three controls from your surroundings.
3. Pick up any eight keywords that describe effective control system.
4. Explain the principle of control by exception at critical points.

# Control

## 25.3 Behavioral Aspects of Managerial Control

<b>Value addition 25.3.1: Focus of the Section</b>
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<b>25.3 Behavioral Aspects of Managerial Control</b>
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Now that you are aware of the concept, kind and process of control, we come to a very important aspect of managerial control and that is its behavioral aspect. This section spells out why control has been shunned by everyone. The findings of Tennenbaun about its impact are also mentioned. Once you know why people despise control and are resistant to control, you should also know how to overcome this resistance as we cannot do away with control. This section suggests a number of measures to do so.
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Control is all about setting standards, measuring and evaluating performance, comparing with set standards and taking corrective actions if there are significant deviations. It increases organizations effectiveness. However the responses of subordinates are quite different from the purpose for which they are designed. The behavioral aspect of control is a cause of concern for all as the recognition of human element is significant factor while designing a control system. It is quite human that people don't want to be controlled. They look at it as an impediment to freedom, and consider it a hurdle in achieving their personal goals. It is rather the other way round. They work against control in their organization. They would take the reward for good performance, but would shift the blame to others for poor performance.

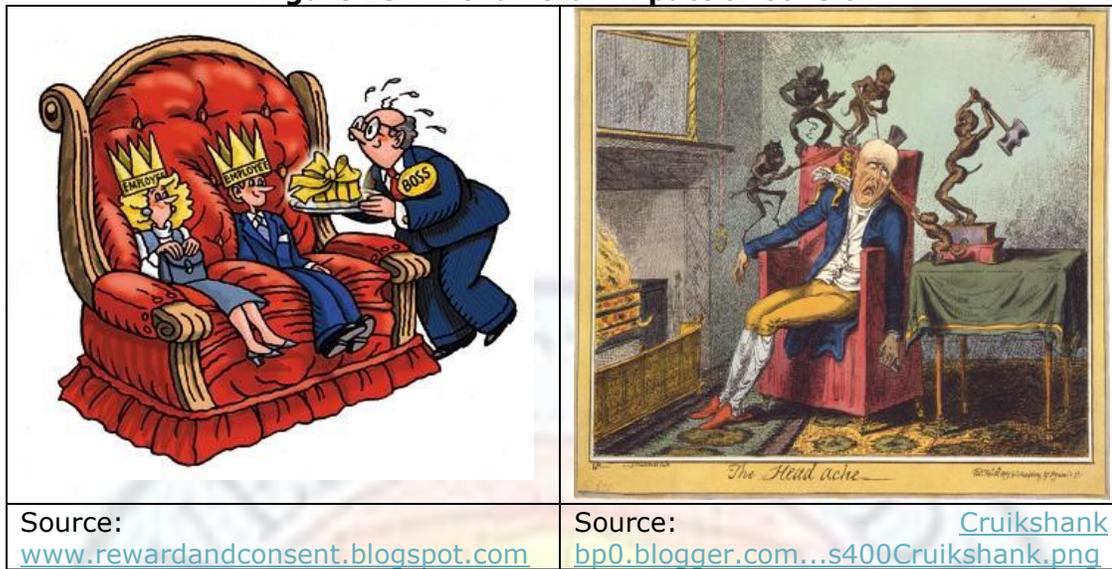
There is yet another angle to be understood in this regard. All the functions of management including control have been designed keeping rationality at its base. But human organizations have proved it otherwise. It is quite unrealistic to assume human organizations as rational and perfect systems. The control systems are designed as if persons working there have machine like efficiency. The behavior of organizations is much more complex. Organization's psycho-social aspects are equally important as their values, views and needs have many dimensions. Control systems can't mechanize the human behavior. Thus control systems should be realistic and semi-rational.

The control of human behavior has never been popular. Nobody wants to admit that one is controlling or being controlled. Both subordinates and superiors have a problem with control. Subordinates resist it as it curtails their freedom and superiors resist it as they fear criticism. In a bureaucratic control system, it is associated with negative verbs such as to curb, to restrict, to command, to police and so on. It resembles a means of oppression. Traditional controls are based on assumption that without the strictness of control, people would behave irresponsibly. Under traditional control, conformity is at premium and creativity is at discount. People tend to behave in a defensive manner because it is punishment-oriented. It becomes rather threat to their security and they remain stressed.

Managers use both planned and unplanned controls, the latter being resisted more because employees are unprepared to accept them. Though its use should be avoided, still its use is unavoidable in the modern organizations for meeting competition, reducing cost, or increasing productivity.

# Control

**Figure 25.4 Behavioral Impact of Control**



The management should try to recognize behavioral implications before exercising control. Though it is desirable to do so, it is not quite practical to follow because of following reasons given by E. Burack.

For one, the human behavior is unpredictable and their responses may be unexpected. Two, information system might not be efficient enough to isolate the factors responsible for resistance. Three, there is a time lag between execution of control and reactions of employees to it.

Control's behavioral implications are not universal as human nature is complex. It has different effect on different people. It makes lot of difference whether the person concerned is at top or bottom of the chain in organization.

The findings of Tannenbaum about the impact of control upon individuals are as follows:

**Control has symbolic implications.** It tells about the person's importance and freedom in the organization. It also tells about what a person must do and must not do.

**Persons who exercise control** are more willing to accept controls upon themselves. They submit to controls as they become more involved and loyal in the whole process. People prefer to exercise self-control as it gives them satisfaction. They are more likely to identify with and support the organization's objectives.

**Persons who are not able to exercise control** tend to be less satisfied with their work and become apathetic and alienated.

## **Reasons for Human Resistance:**

On the basis of discussions given above, the reasons for human resistance can be summarized in following:

- Controls are seen as restriction to freedom.
- It is considered to be instrument of oppression and a symbol of raw authority.
- There is no room for self-control even for people brought up with responsible behavior. Control presumes them to be lazy and irresponsible.
- It restricts creativity of employees by not taking their participation at decision making level.

# Control

- The standards of performance may be rigid and unrealistically high. This is also because employees are not involved at top management level.
- Controls are punishment-oriented and this makes employees defensive as they try to shift blame on others.
- Control presumes that organizational systems are rational and expects human behavior to be perfect.
- The controls are mostly administered in a discriminatory, arbitrary and whimsical manner.

## **Measures to overcome resistance to control:**

There is enough resistance and reasons to support resistance, don't mean that there should be no control. Whatever may be the behavioral implications, controls are needed as they create predictability in the behavior of workforce. Organizations can't give it up as it is a tool to ensure that employees work as per rules, procedures and standards of the organization in pursuit of its goal. Organizations should try to overcome them by adopting following means:

### **Participation since the beginning**

Employees should be involved since the stage of setting the standards for their performances. This encourages feeling of commitment and loyalty. It develops mutual understanding of objectives.

### **Balancing freedom and control**

Freedom is incomplete without control. Organizations and employees need both freedom and control in pursuing their organizational and individual goals. But there should be a balance between the two. Freedom is needed for allowing more options and control is needed for bringing consistency order and stability.

### **Positive reinforcement**

When worker's performance differs from the set standards, she should be given positive reinforcement and not be punished for it. The reasons for deviations must be established and corrections be communicated to worker. Reward system should be integrated with control system.

### **Discourage Discrimination**

There should be consistent behavior from top management to all employees in exercising control. It should not give undue powers to discriminate among employees.

### **Two-way communications**

The employee should have a say in the whole process and should be allowed to give their reactions to the top management. Managers on their part should also be persuasive and communicate that controls are directed to achieve the goals of the organization and not to curtail their freedom.

### **Self-control**

Control should be directed towards emphasizing self-control rather than suppression. It should not kill their self expression and development.

### **Flexible and realistic**

The controls should be realistic and flexible and allow for normal human behavior.

### **Control by exception**

Management should trust their work force and control by exception at critical points should be the rule.

### **Subtle Control**

Control to be more effective should be less visible and conspicuous. It should be administered in an informal, indirect and subtle manner.

# Control

<b>Value addition 25.3.2: Check Your Progress</b>
<b>25.3 Behavioral Aspects of Managerial Control</b>
<ol style="list-style-type: none"> <li>1. State true or false: Employee is resistant to control as it is considered to be an instrument of oppression and a symbol of raw authority.</li> <li>2. One of the following is not the reason for resistance to control:             <ol style="list-style-type: none"> <li>(a) It restricts their freedom.</li> <li>(b) Good performance is rewarded.</li> <li>(c) It leads to oppression of creativity.</li> <li>(d) It is punishment oriented.</li> </ol> </li> </ol>
Answer: 1. True. 2. (b).

<b>Value addition 25.3.3.: Check Your Comprehension</b>									
<b>25.3 Behavioral Aspects of Managerial Control</b>									
<ol style="list-style-type: none"> <li>1. This is one of the measures to overcome resistance to control:             <ol style="list-style-type: none"> <li>(a) Control should be rigid, not allowing anyone to disagree.</li> <li>(b) Every deviation should be controlled.</li> <li>(c) It should be loud and direct.</li> <li>(d) Management should encourage self-control.</li> </ol> </li> <li>2. The following can't be true about impact of control:             <ol style="list-style-type: none"> <li>(a) It tells about the person's importance and freedom in the organization.</li> <li>(b) Persons who exercise control are more likely to identify with the organization's objectives.</li> <li>(c) Persons who exercise control are more willing to accept controls upon themselves.</li> <li>(d) Persons who exercise control tend to be less satisfied with their work and become apathetic and alienated.</li> </ol> </li> </ol> <p><b>Pick the option that best suits.</b>  <b>This section...</b></p> <table border="1" style="width: 100%; text-align: center;"> <tr> <td><b>Completely understood</b> <input type="checkbox"/></td> <td><b>Partially Understood</b> <input type="checkbox"/></td> <td><b>Not understood</b> <input type="checkbox"/></td> </tr> <tr> <td>↓</td> <td>↓</td> <td>↓</td> </tr> <tr> <td><b>Move on to next section</b></td> <td><b>Move on to next section but note that you need to revise this.</b></td> <td><b>You need to re read this and discuss it with your batch mates.</b></td> </tr> </table>	<b>Completely understood</b> <input type="checkbox"/>	<b>Partially Understood</b> <input type="checkbox"/>	<b>Not understood</b> <input type="checkbox"/>	↓	↓	↓	<b>Move on to next section</b>	<b>Move on to next section but note that you need to revise this.</b>	<b>You need to re read this and discuss it with your batch mates.</b>
<b>Completely understood</b> <input type="checkbox"/>	<b>Partially Understood</b> <input type="checkbox"/>	<b>Not understood</b> <input type="checkbox"/>							
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<b>Move on to next section</b>	<b>Move on to next section but note that you need to revise this.</b>	<b>You need to re read this and discuss it with your batch mates.</b>							
Answer: 1. (d). 2. (d). Reason: Persons who are not able to exercise control tend to be less satisfied with their work and become apathetic and alienated.									

<b>Value addition 25.3.4: Test Yourself</b>
<b>25.3 Behavioral Aspects of Managerial Control</b>
<ol style="list-style-type: none"> <li>1. Pick up any five keywords that describe the resistance to control.</li> <li>2. Pick up any five keywords that suggest measures to overcome resistance to control.</li> </ol>

# Control

## 25.4 Modern Control Techniques

### Value addition 25.4.1: Focus of the Section

#### 25.4 Modern Control Techniques

After discussing the concept, process and behavioral aspect of control let's discuss some modern control techniques. The techniques fall into two categories: traditional and modern. Traditional techniques are not discussed in this chapter as they are not included in the syllabus. The modern control techniques: Balanced Scorecard (BSC), Ratio analysis. Economic Value Added (EVA), Market Value Added (MVA) are discussed here. Besides these, there are other modern techniques such as Management audit, Management information system (MIS), Responsibility accounting, Network techniques (PERT and CPM), Total quality management (TQM). In this chapter we are discussing only first four techniques. TQM is discussed in Chapter 13: Operations whereas MIS is dealt in Chapter 20: Decision making. We first take up Balanced Scorecard (BSC) or stakeholders' approach. Read the four focus areas which help in achieving an ideal BSC control system. Study them carefully to understand how this measurement system is envisioned. Next we discuss another control technique 'Ratio analysis', which is an accounting measure. Then we discuss another control technique 'Economic Value Added', which is a financial measure. Next we discuss another control technique 'Market Value Added', which is a financial measure of control. Read each of these techniques to understand what it means, its measuring formulae and its importance as a controlling technique. Note how MVA is different from EVA and Shareholder's value approach.

Control techniques provide every type of information in adequate amount that managers need while measuring and monitoring performance. The information from various controls should be able to serve the needs of specific management level, department, unit, or operation.

There are two categories in which control techniques fall: Traditional control and modern control techniques.

Some of the traditional control techniques are: Personal observation, break-even analysis, statistical data and reports, financial control, market control, human resource control, budgetary control and so on. (They are not discussed in this chapter as they are not included in the syllabus.)

Modern control techniques which have gained popularity over the recent years are following:

**Stakeholders' Approach:** Balanced Scorecard

**Accounting Measure:** To judge the overall financial performance the accounting techniques used are following:

Ratio analysis and Return on investment (ROI)

**Economic and Financial Measures:**

Economic Value Added (EVA) and Market Value Added (MVA)

Rest is not within the scope of our syllabus.

# Control

## **25.4.1 Balanced Scorecard (BSC) (Stakeholders' Approach)**

Balanced Scorecard is "a performance measurement tool that looks at four areas- financial, customer, internal processes and people/innovation/growth assets- that contribute to a company's performance."

In the early 1990s, a new approach to strategic management and measurement was developed in the early 1990's by Dr. Robert Kaplan (Harvard business School) and David Norton. This approach was named as 'balanced scorecard'. This approach provides a clear prescription as to what companies should measure in order to 'balance' the financial perspective. Both qualitative and quantitative measures are combined in this approach and also the expectations of different stakeholders are acknowledged.

We need to understand why it is called stakeholders' approach. Every organization has an objective of maximizing shareholders value by earning high rate of return on its investment. Hence, it's important for an organization to perform financially well by being profitable in this competitive scenario. Profit is the final outcome of different independent processes. For this, the firm is expected to provide better goods and services than their competitors to its customers. This requires better internal business processes which in turn are dependent on strengths and learning abilities of organization. Thus the stakeholders' approach is reflected in the four dimensions of BSC: financial, customer, internal business process, and learning and growth.

BSC puts more emphasis on achieving financial objectives and also includes the performance drivers of these objectives. The scorecard measures the performance of an organization across four balanced perspectives.

An organization's vision and outlook towards strategy determines objectives and measures of the scorecard. It helps an organization to clarify its vision and strategy and translates them into actions. It provides feedback for both the internal business processes and external outcomes so that strategic performance and results can be improved continuously. When fully deployed, instead of an academic exercise it transforms strategic planning into the nerve center of an organization.

Over the years, the Balanced Scorecard approach evolved from an improved measurement system to a core management system.

The organizations today are adopting a variety of improvement initiatives like Total Quality Management (TQM), Just In Time (JIT) production and distribution systems, employee-empowerment, building customer-focused organizations, activity based cost management, and so on. Balanced Scorecard approach as a tool is based on the modern principles of TQM.

According to BSC, there are four perspectives to measure organizational performance, namely, financial, customer, internal business process, and learning and growth. It is emphasized that financial and non-financial measure must be part of the information system for employees at every level of the organization. The objectives and the measures for Balanced Scorecard are not mere an ad-hoc collection of financial and non-financial performance measures; instead they are derived from a top-down process guided by the mission and strategy of the business.

The Balanced Scorecard should be able to translate mission and strategy of an enterprise into tangible objectives and measures. These measures represent a "balance" between external measures (for shareholders and customers), and internal measures of critical business processes, innovation, and learning and growth. The measure represents a balance between the outcome measures- the results from past efforts and the measures that drive future performance. It tries to measure both the performance and it's drivers. The BSC is more than a tactical or an operational

# Control

measurement system. Now a days, innovative companies are using the scorecard as a strategic management system, to manage and control their strategy for s longer time period.

The four areas of focus which help in achieving an ideal BSC control system are following:

**Clarify and Translate Vision and Strategy:** To implement the balance scorecard in an organization the first step is the understanding of the vision and mission of the company in the right sense. It acts as the blood line of the organization. Every part of the organization should have synergies with each other as per the mission.

**Communicate and Link Strategic Objectives and Measures:** Communicating and educating the people in an organization would ensure that the vision gets translated to mission, and this in term is broken down into goal and objective. Setting goals and objectives and their communication in the right spirit is the key to success. Linking rewards to performance measures ensure the people are motivated and contributing their best for the organization.

**Planning and Target Setting:** Planning in an organization would require breaking down of the mission into measurable and hence controllable action plans. Theses action plans are the targets against which performance of the people would be judged.

**Enhance Strategic Feedback and Learning:** A system with the provision of feedback lacks the scope and willingness for improvement. To achieve continual improvement the system should have enhanced feedback system.

## **The Balanced Scorecard Framework**

According to balanced scorecard approach, one should view the organization from four perspectives, namely (1) learning and growth perspective, 2. business process perspective, 3. customer perspective; 4. financial perspective. In relation to these perspectives metrics development, data collection and analysis takes place.

Their relationship is presented in figure 25.5 above and is explained as follows:

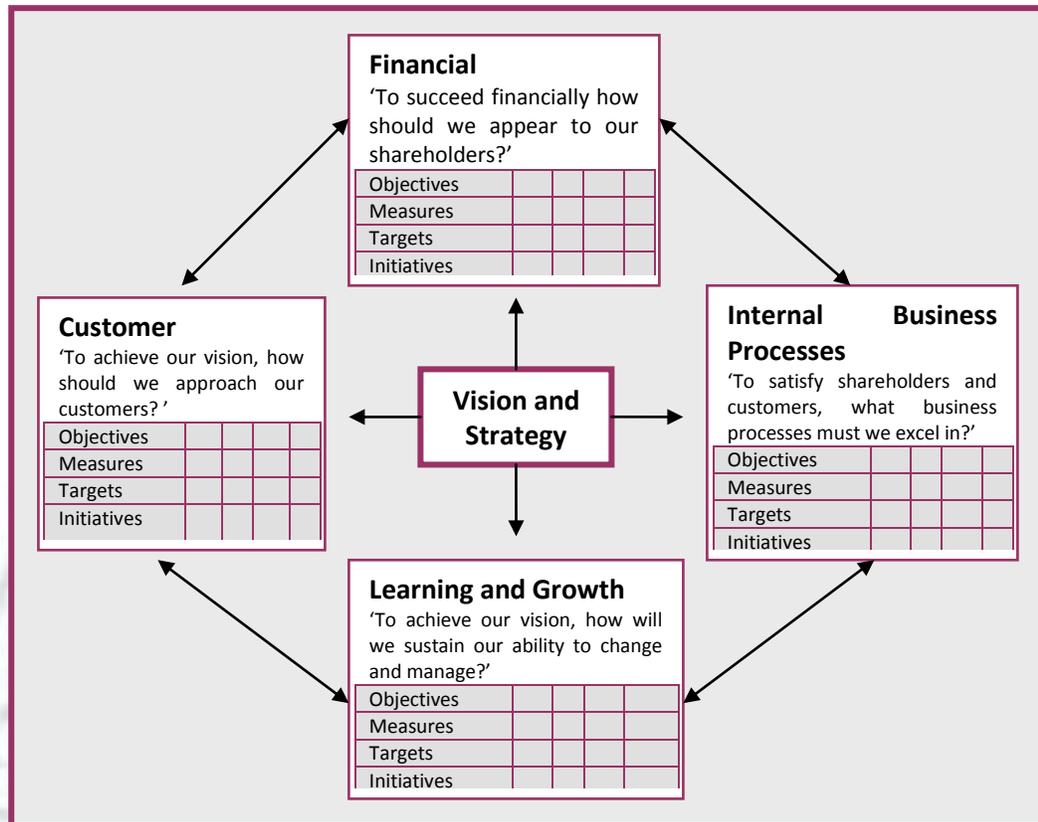
### **The Financial Perspective**

The traditional need for financial data is not disregarded by many people like Norton and Kaplan. Managers take every step to have timely and accurate financial data for the decision making process. They often handle and process more than enough financial data. Implementation of a corporate database is expected to provide centralized and automated processing of financial data. But more emphasis on financial data leads to creation of unbalance situation with regard to other perspectives. This necessitates the inclusion of additional financial data such as cost benefit and risk assessment related data.

### **The Customer Perspective**

In contemporary business environment, increasing, more importance has been put on the customer satisfaction and customer focus. If customers are not satisfied, they generally shift to other suppliers who can fulfill their needs. This continuous trend may lead to decline in future sales even though present performance is good enough. Kinds of customers and kinds of process of which product and services are provided to these customer groups should be analyzed while developing a metrics for satisfaction.

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**Figure 25.5 The Balanced Scorecard Framework**

## The Business Process Perspective

The business process perspective is related to internal business processes. Its metrics help managers to know about the success of their business and to check whether products and services of the organization are able to satisfy the needs of the customers. These metrics should be designed by those who have intimate knowledge of these processes and mission because these cannot be developed by outside consultants. Apart from strategic management processes, there are two other kinds of business processes identified, namely, mission-oriented processes and support processes. Mission-oriented processes mainly serve the special functions of the government offices, but many problems are encountered in these processes. Support processes are mainly of repetitive nature and therefore these can be easily measured.

## The Learning and Growth Perspective

In this perspective, an enterprise's strengths and weaknesses are assessed from the viewpoint of the culture of the organization. This perspective is also called the organizational perspective. This perspective mainly focuses on employee training and corporate culture to have individual and corporate improvement. In the present technologically changing environment, employees need to learn continuously. Due to the lack of incentives and other factors, government agencies are unable to hire new technical hands, and moreover, sometimes they face a decline in the existing employees. This indicates a shifting of the man-power which must be reversed. Metrics can be used to guide managers in arranging training programs efficiently and effectively. Learning and growth are the two important constituents for the successful establishment of any knowledge-based organization.

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Kaplan and Norton emphasized more on learning than training. They said mentors and tutors helps workers to easily communicate with their peers and readily get solution whenever they face any problem.

**Benefits:** The BSC to chart their vision and strategy and transform them into actions. It is not mere a measurement system but it is a management system which transforms dreams into reality.

It provides timely and adequate information regarding internal business processes and external forces so that continuously strategic performances and results can be improved.

It helps companies to track down financial results along with the progress in vicinity of the organization and therefore acquiring tangible and intangible assets as and when required for the growth of the organization.

It puts more emphasis on the performance drivers of financial objectives. It also figures out plan to achieve financial objectives.

It takes into consideration the parameters of past financial measures along with parameters for the future performance.

Research in this area has shown that organizations which use this approach tend to outperform their counterparts who work without any formal approach for strategic performance management.

The key benefits of using a BSC include:

1. **Improved strategic planning and controlling** – The Balanced Scorecard helps to provide a framework for creating and communicating a business strategy. It helps managers to establish a cause and effect relationship. It also ensures consensus of the workforce for achieving strategic objectives by formulating a strategy map. In order to have desired results it identifies the drivers of the future performance taking into account past performance drivers to chalk out a complete strategy.
2. **Improved strategy communication & execution** – A complete set of strategy and its related components in details helps an organization to easily communicate the strategy externally and internally. It helps to motivate staff and the stakeholders in the delivery and review of strategy. As we know that one cannot execute a plan when it is not understood by everyone in the organization.
3. **Better information management** – it forces organizations to set key performance indicators to ensure measurement of what actually matters for the success of the organization. Organizations using this approach tend earn higher profits through higher quality management information and usage of this information for decision making and management.
4. **Improved performance reporting** – It helps to improve performance of the companies than their counterparts who do not use any formal approach for performance management. Meaningful performance reports and dashboards may lead to transparency by communicating strategies externally and internally.
5. **Better organizational and strategic alignment** – It leads to better alignment of the organization with the strategic objectives in order to ensure participation of the entire workforce to achieve organizational objectives. It helps to align organizational process such as budgeting and risk management to achieve strategic objectives.

# Control

<b>Value addition 25.4.2: Did you Know?</b>
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<b>25.4 Modern Control Techniques</b>
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Almost 50% of the large companies all over the world, particularly in the USA, Northern Europe, UK, Japan and Asia use balance score card approach. A research by Bain & Co suggests that almost 44% of organizations in North America and 26% of the firms in Austria use BSCs. In India also some of the top companies have started use of balance scorecard technique to plan and control. For example Tata Motors is using BSC approach to control.
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<b>Source:</b> <a href="http://www.ap-institute.com/Balanced%20Scorecard.html">http://www.ap-institute.com/Balanced%20Scorecard.html</a>
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## **25.4.2 Ratio Analysis**

The ratio analysis is an important tool of financial analysis for different users of the financial or accounting information. Ratio presence the facts on comparative basis by relating one set of figures with other set of figures.

*"Ratio analysis is the process of analyzing the relationship between two sets of figures relating to two important aspects of the company, for example debts and equity."*

Some of the important ratios used are as follows:

1. Liquidity ratio measures the short-term solvency position of a business organization.
  - (a) Current ratio is measured as Current assets over current liabilities.
  - (b) acid-test ratio or quick ratio is measured as ( Current assets – inventories) over (current liabilities – bank overdraft)
2. Leverage ratio measures the contribution to capital made by owners vis-à-vis creditors.
  - (a) Debt-Equity ratio is long term debts over net worth
3. Activity ratio measures the efficiency with which the resources of organization are utilized.
  - (a) Inventory turnover ratio is sales or cost of good sold to average stock.
  - (b) Fixed assets turnover ratio is net sales divided bt net fixed assets.
4. Profitability ratio measures the relationship between profit and capital employed or sales.
  - (a) Return on capital Employed is calculated by dividing profit before interest, tax and dividend by capital plus free recerves.
  - (b) Profit on sales ratio is earnings before interest and tax by sales.

### **Importance of Ratios**

Ratio analysis has following uses:

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1. **Simplified figures:** The single figures in terms of absolute amounts such as Rs 50 lakhs income, Rs70 lakhs sales etc. are not of much use. They become important when relationships are established.
2. **Simplified analysis:** It is easy to understand financial position of a firm in respect of its solvency, profitability, capital structure etc.
3. **Inter-firm Comparison:** It is possible to compare the results of one firm with another firm within the same industry with the help of ratios. For example: Sales turnover ratio of one cement firm can be compared with another cement firm.
4. **Locating Weak points and taking corrective action:** Ratio analysis helps in finding deficiency in various departments by comparing the actual rate with target rate. If these targets are not achieved, corrective actions are taken.
5. **Forecasting:** Ratio analysis helps in forecasting the future results by analysis the ratios of lasts few years.
6. **Decision making:** Ratio Analysis helps in collecting information for those who have stake in the company. For example, banks are interested in finding the liquidity position of the firm so that their loans are repaid and to decide whether to issue more loans. Long-term creditors are interested in knowing solvency ratio of the firm. Investors make use of profitability to decide whether to retain their capital in the company.

Almost every company makes use of ratio analysis as a control measure.

## Return on Investment (ROI)

Return on Investment is yet another accounting measure quite similar to ratio analysis method of evaluating financial performance of the company. Every organization whether small or big, seeks to earn return on its investment for the risk undertaken. It is the ratio of earnings to its investment. Here profit is not taken as an absolute figure but in relation to capital invested. The yardstick is the rate of return that a company should earn on capital allocated to it. It is calculated as under:

$$\text{ROI} = \text{E/I}$$

Where, E stands for Earnings which can be before tax or after tax and I stands for investment which includes working capital and fixed assets used in business. Total Investment can also be calculated by adding capital and free reserves.

This has been used as a core of the control system of the Du Pont Company.

Since ROI is calculated as a relative figure, comparison with other firms is possible even if they have different profits and investments. It is also useful for inter-divisional analysis. It also suggests areas where remedial action is required.

<b>Value addition 25.4.3: Did you Know?</b>
<b>25.4 Modern Control Techniques: Ratio Analysis in Banks</b>
Banks and financial institutes faced security problems in past in granting loans and advances but nowadays things have quite changed. Nowadays banks consider financial viability of a proposal along with the security issues. As we know that risk element is present in all decisions relating to credits. Ratio analysis and other quantitative techniques helps banks to assess this risk element so to minimize it.
<b>Source:</b> <a href="http://www.iibf.org.in/uploads/caiib_fm_modc.ppt">www.iibf.org.in/uploads/caiib_fm_modc.ppt</a>

# Control

## **25.4.3 Economic Value Added (EVA)**

EVA is a performance measuring method to calculate true economic profits of an enterprise because traditional financial statements like balance sheet and profit loss account show only absolute figures like net sales and net profit. Anything that has utility and gives satisfaction has a value for itself. Value added is "the wealth created by the reporting entity by its own and its employee's efforts and comprises salaries and wages, fringe benefits, interest, dividend, tax, depreciation and net profits retained."

Economic Value Added is calculated by deducting a charge for the opportunity cost of capital invested from net operating profits.

$$\text{EVA} = \text{Operating Profit after Tax (-) Cost of Capital}$$

EVA estimates the amount of difference between earning and minimum rate of return for shareholders. It shows the excess or deficiency between the two. The idea behind EVA is that return, the shareholders must earn to compensate the risk taken. This means equity should earn at least same return as similarly risky investment at equity markets. If it is not so then the company operates at loss from the shareholder's point of view. If EVA is zero then it means that shareholders are able to compensate the risk. A positive EVA indicates creation of wealth for its shareholders.

Economic value added indicates the amount of economic addition to the assets of an organization. In a way, it measures profit earned by a company over and above normal returns.

According to EVA, managers earn rate of return on their assets above the cost of capital. It compares a company's actual rate of return against its target rate of return and measures its true economic profit.

Rate of return is the rate that a company is expected to earn on its invested capital whereas cost of capital is the minimum rate of return that a company need to earn in order to keep its market value at least unchanged if there is no addition to it. EVA is quite similar to Net Present Value (NPV) approach.

The companies in India using this method of control are Infosys, Hindustan Lever and Cheminor Drugs.

### **How to Improve EVA**

It should try to investing in companies that are likely to earn more than its cost of capital.

It should make better utilization of resources for higher productivity and profitability.

It should divest from the less profitable units.

It should motivate employees by linking incentive pay with EVA.

EVA can be used for the settinh organizational goals, performance and measurement, bonus determination, capital budgeting, and motivation of the investors.

### **Benefits**

Amongst its benefits, it is maximization of company's returns over its cost of capital which means it gives importance to managers and employees. It tries to achieve minimum cost of capital and hence optimum capital structure.

# Control

## **25.2.4 Market Value Added (MVA)**

Market value added (MVA) is defined as the increment in total value of a company over and above the amount actually invested by the shareholders.

MVA is the difference between the market value and invested capital.

$$\text{MVA} = \text{Market Value} - \text{Invested Capital}$$

The concept of MVA is quite different from the concepts of Shareholder Value and EVA. The shareholder value shows the present value of all anticipated future streams of cash flows from the business plus the value of the company at the time of winding up of the company. EVA is valued addition to the shareholders wealth by generating operational profit over and above the cost of capital. MVA is the sum total of market value of debt and market value of equity.

The higher MVA is better for the organization as well as for the sustained growth of the shareholders. It is seen that a firm reporting higher EVA for a longer time period tend to have high MVA which present value of future expected EVAs. A negative MVA shows the destruction of the shareholders wealth.

The concept of MVA is most suitable for healthcare companies like hospitals and nursing homes which are owned by the investors whereas EVA is most appropriate for non-profit organization.

There are two **limitations** of MVA. First, it does not take into account the opportunity cost of invested capital. Second, it ignores interim cash returns to shareholders. Third, it is possible to calculate MVA at divisional levels.

<b>Value addition 25.4.4: Surf and Learn</b>
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<b>25.4 Modern Control Techniques</b>
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Surf the net and find a company using Balanced Score Card technique of Control. Note down the information gathered from there.
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<b>Value addition 25.4.5: Check Your Progress</b>
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<b>25.4 Modern Control Techniques</b>
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Tick as true or false:

1. BSC puts more emphasis on achieving financial objectives but ignores the performance drivers of these financial objectives.
2. Economic value added approach indicates the amount of economic value addition to company's assets.

Answer 1. False. Reason: BSC puts more emphasis on achieving financial objectives and also considers performance drivers of these financial objectives. 2. True.
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<b>Value addition 25.4.6: Check Your Comprehension</b>
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<b>25.4 Modern Control Techniques</b>
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Match the following columns:

Column A	Column B
(a) It is the ratio of earnings to its investment.	(i) MVA
(b) It is helpful in finding the liquidity position of the firm	(ii) EVA
(c) It is sum total of the present value of all future expected economic values.	(iii) Ratio Analysis
(d) It is that return, the shareholders must earn to compensate the risk taken.	(iv) Return on Investment

# Control

**Pick the option that best suits.**

**This section...**

**Completely understood**

**Partially Understood**

**Not understood**



**Move on to next section**

**Move on to next section but note that you need to revise this.**

**You need to re read this and discuss it with your batch mates.**

Answer: (a)-(iv), (b)-(iii), (c)-(i), (d)-(ii)

## **Value addition 25.4.7: Test Yourself**

### **25.4 Modern Control Techniques**

1. What is balanced scorecard?
2. Why is BSC considered 'balanced'?
3. Discuss Ratio analysis as a control technique.
4. Pick up any three keywords that describe Economic Value Added as a controlling technique.
5. Briefly comment on the 'Market Value Added' as a technique of control.

## **Value addition 25.4.8: Key Words**

### **Summary**

[Forward-looking](#)

[Control and Planning](#)

[Feedback control](#)

[Feed-forward Control](#)

[Concurrent control](#)

[Management by Exception](#)

[Critical Point Control](#)

[Self-control](#)

[Balanced Scorecard](#)

[Ratio Analysis](#)

[Economic Value Added \(EVA\)](#)

[Market Value Added \(MVA\)](#)

[Resistance to control](#)

[Measures to Overcome Resistance](#)

# Control

## Summary

- The managerial function of controlling is the measurement and correction of performance in order to ensure achievement of organizational objectives.
- Control techniques and systems are basically the same. The basic control process involves four steps namely establishing standards, measuring performance, estimating deviations, and taking corrective actions. Control should be designed to handle critical points.
- Managerial control is very similar to common household system where there is free flow of information. Even when the flow of information is free there could be delay in taking corrective actions. It is suggested that instead of feedback control alone managers should utilize a feed-forward approach.
- If controls are to work they must be tailor-made to ensure effective and efficient achievement of plans. Effective control system should be designed to be objective, custom to the organizational culture, economical, and leading to corrective actions.
- The behavioral aspect of control is generally a cause of concern while designing a control system due to recognition of human resource element. It is quite natural that workforce doesn't want to be controlled. The organization is bound to face enough resistance but it does not mean that there should be not no control. Every organization should try to adopt certain means like positive reinforcement to overcome resistance for control.
- A variety of control techniques have been used by managers to exercise control. Modern control techniques have gained popularity over the recent years. This includes stakeholders approach (Balanced Scorecard); accounting measures such as Ratio analysis; economic and financial measures such as Economic value added and Market value added approaches.

# Control

## Exercises

### Short Questions

- 25.1 Define control. What are its characteristics?
- 25.2 Define briefly the relationship between control and planning.
- 25.3 What is feed-forward control?
- 25.4 What do you mean by Balanced Scorecard?
- 25.5 What is 'Economic Value Added' technique?
- 25.6 Write short notes on the following:
  - i. Market Value Added
  - ii. Management by exception
  - iii. Critical point control
  - iv. Stakeholders' approach
  - v. Return on Investment

### Long Questions

- 25.7 Explain the meaning, nature and importance of controlling function.
- 25.8 State the reasons for human resistance to control. Suggest ways to overcome this resistance.
- 25.9 Explain the meaning and various steps involved in the process of control.
- 25.10 "Planning is an empty exercise without controlling." Comment.
- 25.11 "The essence of control is action." Comment.
- 25.12 Explain the process of managerial control. What are the principles of an effective control system?
- 25.13 Write a critical note on behavioural aspect of management control.
- 25.14 What do you mean by Balanced Score Card? Why is it called balanced approach?

### Value addition 25.4.9: Past University Questions

#### Control

- 25.1 2008 (Regular) Q5 (b): In what ways is the function of control important in management? (4 marks)
- 25.2 2007 (Regular) Q 4(b): Explain the process of managerial control. (2and1/2 marks).
- 25.3 2008 (Regular) Q5 (b): Explain the steps in the process of control.
- 25.4 2007 (Regular) Q 4(b): What are the principles of an effective control system?  
(2and1/2 marks)
- 25.6 2005(regular) Q 6(a): Write a critical note on 'Behavioral Aspects of Marginal Control.'(5marks)
- 25.7 2007(correspondence) Q5 (a): Discuss the behavioural aspects of managerial control. (7marks).
- 25.8 2008 (Regular) Q5 (a): write notes on Balance Scorecard
- 25.9 2006 (Regular) Q 5 (b): Briefly comment on the 'Economic Value Added' as a technique of control. (5 marks)
- 25.10 2010 (Regular) Q 5: Write note on Economic Value Added (EVA). (5 marks)

# Control

## Glossary

**Bureaucratic control:** Bureaucratic control is the use of rules, policies, and hierarchy of authority, written documentation, reward systems, and other formal mechanisms to influence employee behavior and assess performance. Bureaucratic control can be used when behavior can be controlled with market or price mechanisms.

**Clan control:** Clan control represents cultural values almost the opposite of bureaucratic control. Clan control relies on values, beliefs, corporate culture, shared norms, and informal relationships to regulate employee behaviors and facilitate the reaching of organizational goals. Organizations that use clan control require trust among their employees.

**Management Control:** The management control system is designed once the goals are agreed and aims to inform the management of progress towards these goals. In this way management control is a system of processes only intended to facilitate the achievement of these goals, the goals themselves are taken as given. This also implies that it is concerned with processes and systems used primarily by line managers.

**Market Control:** Market control involves the use of price competition to evaluate output. Managers compare profits and prices to determine the efficiency of their organization. In order to use market control, there must be a reasonable level of competition in the goods or service area and it must be possible to specify requirements clearly.

**Net Present Value (NPV) Approach:** It is based on Shareholder Value which is the present value of the anticipated future streams of cash flows from the business plus the value of the company if it is liquidated.

**Operational Control:** Rather than dealing with organization as a whole, operational control systems are more concerned with individual tasks or transactions. These types of control systems are highly automatic and are analogous to a simple definition of control. This is the most basic level of control process involving little more than regulation.

# Control

## References

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<http://www.ap-institute.com/Balanced%20Scorecard.html>

### 2. Suggested Readings

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Robert N Anthony (1970). *The management control function*. Boston, Mass.: Harvard Business School Press. pp. 14–17.

### 3. **Web Links**

25.1 Visit the URL <http://www.2gc.co.uk/pdf/2GC-W0412.pdf> and learn more about Generations of Balanced Scorecard.

25.2 Visit the URL

<http://www.nri.co.jp/english/opinion/papers/2002/pdf/np200245.pdf> and learn more about Balanced Scorecard.

