**Elements of a Control System**

1. A detector or sensor –

A device that measures what is actually happening in the process being controlled.

1. An assessor –

A device that determines the significance of what is actually happening by comparing it with some standard or expectation of what should happen.

1. An effector –

A device (often called ‘feedback’) that alters behaviour if the assessor indicates the need to do so.

1. A communications network –

A devices that transmit information between the detector and the assessor and between the assessor and the effector.

**Management Control**

 Management control is the process by which managers influence other members of the organization to implement the organization’s strategies.

**The Four Levers of Control**

1. Core values :

controlled by Belief systems, such as mission statements, vision statements, credos and statements of purpose

1. Risks to be Avoided :

controlled by Boundary Systems, such as Codes of conduct, predefined strategic planning methods, asset acquisition regulations, operational guidelines

1. Strategic Uncertainties :

controlled by Interactive Control Systems, such as incorporating process data into management interaction, face to face meetings with employees, challenging data, assumptions and action plans of subordinates

1. Critical Performance Variables :

controlled by Diagnostic Control Systems, such as output measurement, valuation standards, incentive systems and compensation systems.

**Formal Control Process:**

 A strategic plan implements the organization’s goals and strategies. All available information is used in making this plan. The strategic plan is converted to an annual budget that focuses on the planned revenues and expenses for individual responsibility centres. Responsibility centres are also guided by a large number of rules and formal information. Process of formal management control.

* Determination of standards or norms to be used in measuring actual results.
* Measurement of actual results vis-à-vis planned results in the same lines/same areas as per standards and norms set earlier.
* Identification and analysis of the gap between the expected and actual results
* Initiating remedial action to correct the shortfall or to provide an acceptable basis for revising the norms.
* Recycling the information relating to the actual performance for its use in developing future plans

**WHY CONTROL IS NEEDED**

* Helps in achieving the targets;
* Helps in taking corrective action on time;
* Helps in monitoring and improving employees performance
* Helps in achieving better coordination;
* Helps in better scheduling;
* Helps in minimizing errors;
* Facilitates decision creation ;
* Simplifies supervision.

**GOOD CONTROL SYSTEM**

1. Easy:

It should be easy and easily understandable.

1. Clear objectives:

Objectives should be clearly and specifically laid down and expressed in quantitative conditions leaving no scope for subjective interpretation.

1. Appropriate:

It should be appropriate to suit the necessities of the organisation. Control system for a manufacturing concern is to be dissimilar from that of a trading or service organisation.

1. Flexible:

It should be flexible and responsive to changing necessities of the organisation and be adaptable to the new growths.

1. Forward looking:

The control system should be directed towards future. It should indicate the steps to be taken in future so that the deviations do not continue and reduced to the minimum.

1. Concentrate on exceptions:

An effective and economical control system necessity focus attention on factors critical to performance. The important deviations from the average, whether positive or negative should be brought to the knowledge of the management. If we attempt to control every little aspect, the system is likely to make troubles rather than ensuring planned performance, and may prove costly.

1. Efficient control techniques:

The control techniques are measured efficient if they help in detecting the derivations at an early level and help in achieving the desired results. There are several techniques or methods that are used for the purpose of control. The traditional ones are budgetary control and average costing etc. Nowadays, there are a number of techniques used in dissimilar organisations more effectively. Some of these techniques are Break Even Analysis, Programme Evaluation, and Review Technique (PERT), Critical Path Method (CPM), Statistical Excellence Control (SQC), and Management Audit etc

**RESPONSIBILITY CENTER**

 **INITIATIVE, PERSONAL RESPONSIBILITY, AND DELEGATION**

Learning the vital skills for creating initiative in the workplace — specifically preventing upward delegation and effectively delegating appropriate tasks and assignments.—is a critical ability all successful managers‘ necessity learns. New managers or supervisors who fail to develop these skills can easily discover themselves in the trap of doing for employees what employees can and should be doing for themselves. The reasons for doing this are varied.—anything from incorrect ideas of the role of the manager, to require for control, to providing inappropriate ―help‖ to employees. Supervisors and managers who haven‘t thought through these issues can inadvertently hinder the development of initiative and personal responsibility in their employees. Under the guise of ―helping their employees,‖ supervisors and managers step in and do the work that is the employee‘s responsibility. The downstream consequence is the erosion of talent, bench strength, and employee development and motivation. An additional unintended consequence is a waste of the new manager's time.

**Kinds of Responsibility Centers**

**Revenue centers:**

* Output is measured in monetary terms.
* No formal attempt to relate input (i.e. expenses or costs) to output.
* They are marketing organizations that don’t have profit responsibility.
* Area primarily responsible for generating sales such as a sales office /marketing unit
* Measurement of actual sales to the budgeted.
* Unit manager is responsible for the direct expenses within the unit but the
* primary measurement is revenue
* Manager doesn’t have knowledge that is needed to make the cost /revenue trade off required for optimum marketing decisions.
* They don’t set selling prices and are not charged for the cost of goods.

**Expense centers:**

Inputs or expenses are measured in monetary terms, but outputs are not.

Two general types of expense centers:

* Engineered expense centers:
* Engineered costs are for which the ‘right’ or ‘proper’

amount can be estimated with reasonable reliability’

* Inputs can be measured in monetary terms
* Their outputs can be measured in physical terms
* The optimum amount of input required to produce one

unit of output can be determined

* Usually found in manufacturing operations, warehousing, distributions.

**Administrative and Support centers**

Administrative centers include sr. corporate management and business unit management along with the mangers of supporting staff units.

Support centers are units that provide services to other responsibility centers and they often charge for the same. Support centers often charge the other responsibility centers for the services that they provide.

 E.g. IT dept can charge sales dept for the services Functions are virtually impossible to quantify, much less evaluate.

**Cost centre (business)**:

In business, a cost centre or cost center is a division that adds to the cost of an organization, but only indirectly adds to its profit. Typical examples contain research and development, marketing and customer service. There are some important advantages to classifying easy, straightforward divisions as cost centers, since cost is easy to measure. Though, cost centers make incentives for managers to under fund their elements in order to benefit themselves, and this under funding may result in adverse consequences for the company as a whole.

 **Profit center**:

A profit center is a part of a company treated as a separate business. Therefore profits or losses for a profit center are calculated separately. A profit center manager is held accountable for both revenues, and costs (expenses), and so, profits. What this means in conditions of managerial responsibilities is that the manager has to drive the sales revenue generating behaviors which leads to cash inflows and at the similar time control the cost (cash outflows) causing behaviors. This creates the profit center management more demanding than cost center management. Profit center management is equivalent to running a self-governing business because a profit center business element or department is treated as a separate entity enabling revenues and expenses to be determined and its profitability to be measured.

Business organizations may be organized in conditions of profit centers where the profit center's revenues and expenses are held separate from the main company's in order to determine their profitability. Usually dissimilar profit centers are separated for accounting purposes so that the management can follow how much profit each center creates and compare their relative efficiency and profit. Examples of typical profit centers are a store, a sales organization, and a consulting organization whose profitability can be measured.

Peter Drucker originally coined the condition profit center approximately 1945. He later recanted, calling it "One of the major mistakes I have made." He later asserted that there are only cost centers within a business, and ―The only profit center is a customer whose cheque hasn‘t bounced.

**Investment center**:

An investment center is a classification used for business elements within an enterprise. The essential unit of an investment center is that it is treated as an element which is measured against its use of capital, as opposed to a cost or profit center, which is measured against raw costs or profits. The Investment Center takes care of Revenues, Cost, and Assets -while Profit Center deal presently with revenues and costs and Cost Center with cost only. This is a clear sign of how the span of control and span of accountability grow

**Financial Goal Setting**

 Investment centers represent decentralized units where the manager is given maximum freedom for making decision pertaining not only to the product mix, pricing, customer relationships and production methods but also to determine the level and type of assets used in the unit.

 The performance of an investment centre is thus gauged on the basis of assets employed and by relating the profits to the assets employed. This approach is known as Return on Investment (ROI)

**Return on Investment (ROI)**

 It is the percentage of return on funds invested in the business by its owners In short, this ratio tells the owner whether or not all the efforts put into the business has been worthwhile.

 If the ROI is less than the rate of return on an alternative, risk-free investment such as a bank savings account, the owner may be wiser to sell the instrument, put the money in such a savings instrument, and avoid the daily

struggles of small business management.

The ROI is calculated as follows:

* Return on Investment = Net Profit before Tax / Net Worth

 Financial statements express only monetary aspects; businesses don’t get reflected. Thus ROI doesn’t give a complete picture of the happenings in a business. ROI leads to excessive focus on improving profitability and not wealth maximization or shareholder value maximization, recognition, social wealth etc.

**Economic Value Added (EVA)**

 Implies the difference between net operating profits after taxes and total cost of funds. It offers a consistent approach to setting goals and measuring performance, communicating with investors, evaluating strategies and allocating capital. It is the measure that captures the true economic profit of the organization.

Maximizing EVA means the same as maximizing long term yield on shareholders’ investment.

* EVA= Net operating profits after taxes (-) (total capital\*WACC)
* NOPAT = Operating Income x (1 - Tax Rate)

It is based on the past performance of the corporate Enterprise.

**EPS (Earning Per Share)**

 EPS measures the profits available to the equity shareholders on each share held.

The formula is:

* EPS = Net Profits Available to Equity Holders / Number of Ordinary Shares Outstanding.

**P/E (Price To Earning Ratio)**

 It is the ratio between the market price of the shares of a firm and the firm's earnings per share.

The formula is:

* P/E ratio = Market Price of Share / Earnings per Share

 It indicates the growth, shareholder orientation, and corporate image of a company.

**Transfer Pricing**

 Decentralization- accounting for the transfer of goods and services from one profit center to another.The method followed while establishing price for such transfers is called transfer pricing.Inappropriate pricing for inter divisional transfer of goods or services draws a wrong performance TP is a mechanism for distributing the revenue generated collectively

**Objectives of transfer pricing**

 It should provide each segment with the relevant information required to determine the optimum trade-off between company costs and revenues.

* To measure the real performance and profitability of the division
* To allow autonomy to division but not at the cost of the firm’s goal
* To keep up motivation of all concerned divisions.
* To ensure the cost control at every division.

**Performance Measurement and control**

 Managers function- to ensure that the work gets done efficiently and effectively. They literally don’t “control costs”. They try to influence the actions of the people who are responsible for incurring the costs. Performance measurement improves the likelihood the organization will implement its strategy successfully.

In MCS, the manager works through others in the following ways

* Selecting employees
* Making sure the employees are adequately trained
* Deciding where the employees fit best in the organization
* Empowering employees
* Providing advice and suggestions
* Solving problems
* Ensuring that the work environment is satisfactory
* Disciplining
* Resolving disputes within the responsibility center
* Approving proposed actions that employees are not authorized to take
* Interacting with other managers to obtain their cooperation and to resolve problems when their activities impede the work of the responsibility center
* Seeking to create a climate that induces employees to work efficiently and effectively

**Standard cost as transfer price**

Scientifically predetermined cost of production and not actual costs. It motivates the division to contain its costs within prescribed limits.

**Full cost as transfer price**

 Recovery of full cost of production But here, the inefficiencies of one division will be passed on to the another division and no incentive for cost control.

**Variable cost as transfer price**

 Only variable cost of production is taken into consideration by ignoring the fixed cost. Logic is, why to consider fixed cost which has already been committed irrespective of the purchase decision of another division. But, neither profit nor the recovery of the full cost.

**Market price as transfer price**

 It is the best transfer price, as it represents the opportunity cost from the point of view of both the divisions are concerned. Primary conditions for establishing MP as transfer price are:

 There should be open market for the one’s products i.e. the other has open option to outsource its requirements. The market price is determined by fair & competitive market forces

**Margin based pricing**

The profit markup Two decisions,

* what the profit markup is based on and
* The level of profit allowed

 Widely used base is a % of costs, or % of investment.

 To the extent possible the profit allowance should approximate the rate of return that would be earned if the business unit were an independent company selling to outside customers

**Performance Measurement Systems**

 PMS have the goal of strategy implementation.

 In setting up a PMS, senior management selects a series of measures that best represent the company’s strategy. These measures can be seen as current and future critical success factors. If these factors are improved, then the company has implemented its strategy.

 It is a mechanism for improving the likelihood of the organization successfully implementing a strategy Financial measures of corporate success-profits and revenues, show the results of past decisions the company has taken.

 Under PMS, a blend of financial and non-financial measurements are used at all levels in the organization.

 Financial measures indicate the results of past decisions, whereas non-financial are leading indicators of future performance.

 A PMS like dashboard, has a series of measures that provide information about the operation of many different processes. Example of PMS is Balanced Scorecard

**The Balanced Scorecard**

 It fosters a balance between otherwise disparate strategic measures in an effort to achieve goal congruence, thus encouraging employees to act in the best interest of the organization.

 The balanced scorecard is tool for focusing the organization, improving communication, setting organizational objectives and providing feedback on strategy.

 Every measure on a balanced scorecard addresses an aspect of a company’s strategy.

 In creating the balance scorecard, executives must choose a set of measurements that

* Accurately reflect the critical factors that will determine the success of the company’s strategy
* Show the relationships among the individual measures in a cause effect manner, indicating how non-financial measures affect long term financial results and
* Provide a broad-based view of the current status of the company.
* The balanced scorecard approach also focuses on what managers are currently doing to create future shareholder value.

 Performance reporting approach which links organizational strategy to actions of managers and employees Combines financial and operating measures. BU should be assigned goals and then measured from the four perspectives

 **Exchange rate**

Exchange rate is the rate at which one currency is exchanged for another. Thus, an exchange rate can be regarded as the price of one currency in terms of another. An exchange rate is a ratio between two monies

For example: If 5 UK pounds or 5 US dollars buy Indian goods worth Rs. 400 and Rs. 250 then pound- rupee or dollar-rupee exchange rate becomes Rs. 80 = £1 or Rs. 50 = $1, respectively. Ex­change rate is usually quoted in terms of ru­pees per unit of foreign currencies. Thus, an exchange rate indicates external purchasing power of money.

### **Multinational Companies**

A multinational company is one which is incorporated in one country (called the home country); but whose operations extend beyond the home country and which carries on business in other countries (called the host countries) in addition to the home country.

### **Features of Multinational Corporations (MNCs):**

#### **(i) Huge Assets and Turnover:**

Because of operations on a global basis, MNCs have huge physical and financial assets. This also results in huge turnover (sales) of MNCs. In fact, in terms of assets and turnover, many MNCs are bigger than national economies of several countries.

#### **(ii) International Operations Through a Network of Branches:**

MNCs have production and marketing operations in several countries; operating through a network of branches, subsidiaries and affiliates in host countries.

#### **(iii) Unity of Control:**

MNCs are characterized by unity of control. MNCs control business activities of their branches in foreign countries through head office located in the home country. Managements of branches operate within the policy framework of the parent corporation.

#### **(iv) Mighty Economic Power:**

MNCs are powerful economic entities. They keep on adding to their economic power through constant mergers and acquisitions of companies, in host countries.

#### **(v) Advanced and Sophisticated Technology:**

Generally, a MNC has at its command advanced and sophisticated technology. It employs capital intensive technology in manufacturing and marketing.

#### **(vi) Professional Management:**

A MNC employs professionally trained managers to handle huge funds, advanced technology and international business operations.

#### **(vii)Aggressive Advertising and Marketing:**

MNCs spend huge sums of money on advertising and marketing to secure international business. This is, perhaps, the biggest strategy of success of MNCs. Because of this strategy, they are able to sell whatever products/services, they produce/generate.

#### **(viii) Better Quality of Products:**

A MNC has to compete on the world level. It, therefore, has to pay special attention to the quality of its products.