Management Accounting
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Lecture: 58
Management Control System and Responsibility Accounting- II

Welcome all! So we are discussing the concept of responsibility accounting and I discussed with you the concept of this State Power boards, who were in a very bad financial position because of not being clearly known, that is who is responsible for the generation, who is responsible for the transmission, who is responsible for the distribution. But now when this whole board, whole power company is converted into the different is broken down into the different responsibility centers; and these three generation, transmission and distribution functions we have segregated clearly.

We are able to find out whether there is a problem at the generation level, whether is a problem at the transmission level or whether there is a problem at the distribution level. So we have made the things very clear here, and now the overall health of the power boards is improving, because collection of the power distributed to the people, to the customers, final users has improved, right. Once it has improved to money has started coming back to the transmission companies, to the generation companies, so overall process has become improved.

Same is the concept of the responsibility accounting or responsibility centers in the say, business organizations that when you (say) bifurcate the whole firm or you divide and sub divide the whole firm into units and sub units, you are able to find out there is a problem; and that means the problem there only, the loopholes there only can be easily plugged and when you plug the look holes, certainly means if somebody is doing very well you are able to find out that also.

If somebody is not doing up to the mark you are able to find out that also and somebody who is able to do much better you motivate him, encourage him and you reward him. The other person who is not able to do it, who is not able to contribute, who is not able to give up to the desired amount you can take the corrective actions at that level and plug the leakages or the loopholes. So this entire system will stand improved, gained and further strengthened.

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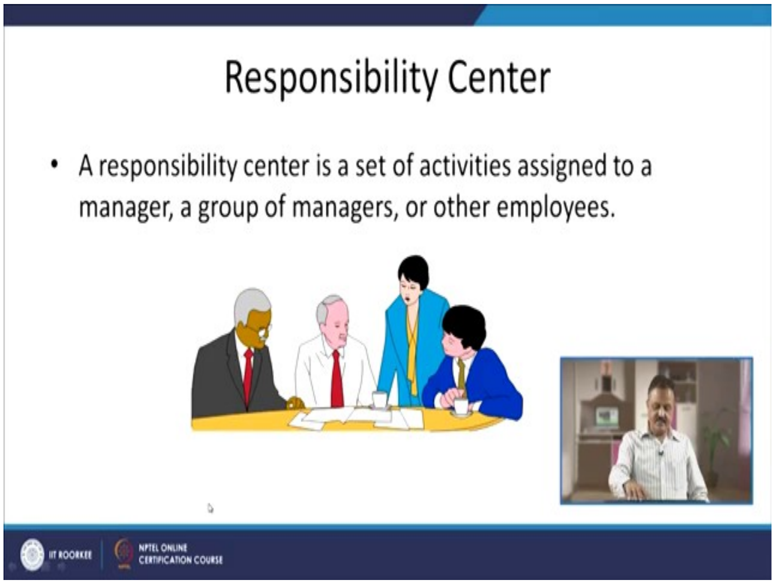

So I would say here a responsibility center is a set of activities assigned to a manager a group of managers or other employees; to a manager, group of managers and other employees. This is called as the responsibility center and I have discussed with you in detail the concept of responsibility centers.

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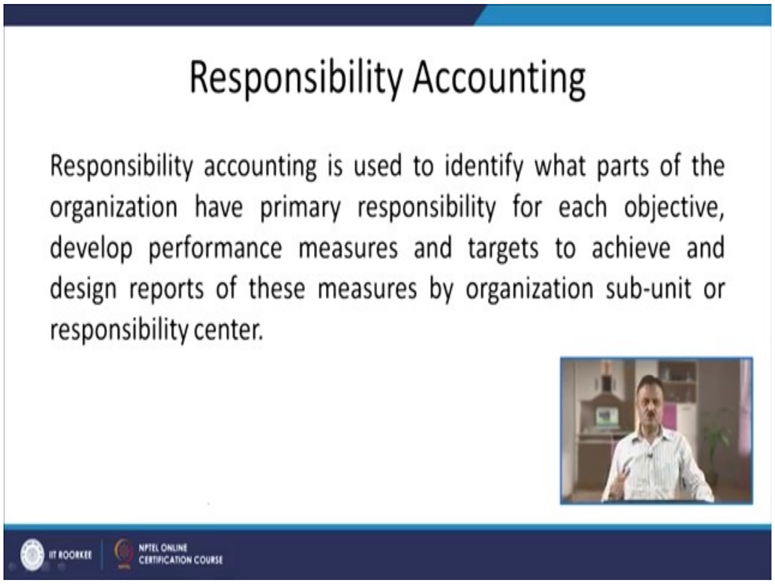

Now we'll talk about the responsibility accounting. Responsibility accounting is basically used to identify what parts of the organization have primary responsibility for each objective. We have the different objectives; we have to go for the procurement of material, one objective. Second is we have to go for properly receiving the material and storing it, second objective. Then we have to issue the material to different manufacturing processes, process one, two, three, four then, that is another objective. Then the material has to go from the production facility to the either to the market or to the warehouse, that's another.

So who is responsible for these different activities? That's clearly defined and laid down. So what part of the organization have the primary responsibility for the each objective, developed performance measures and targets, to achieve and design reports of these measures by organization's sub units or responsibility centers.

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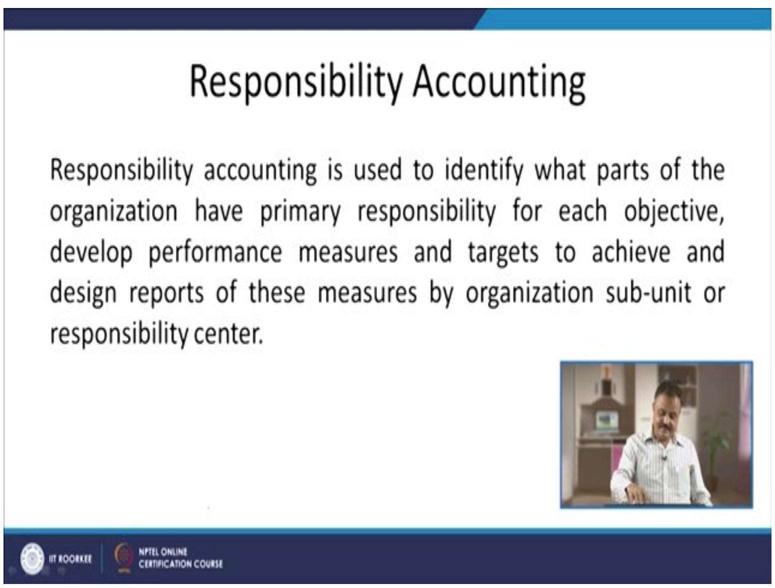

So it is used to identify what parts of the organization have primary responsibility for each objective, developed performance measure and targets to achieve and design reports of these measures by the organization's sub-unit or the responsibility centers.

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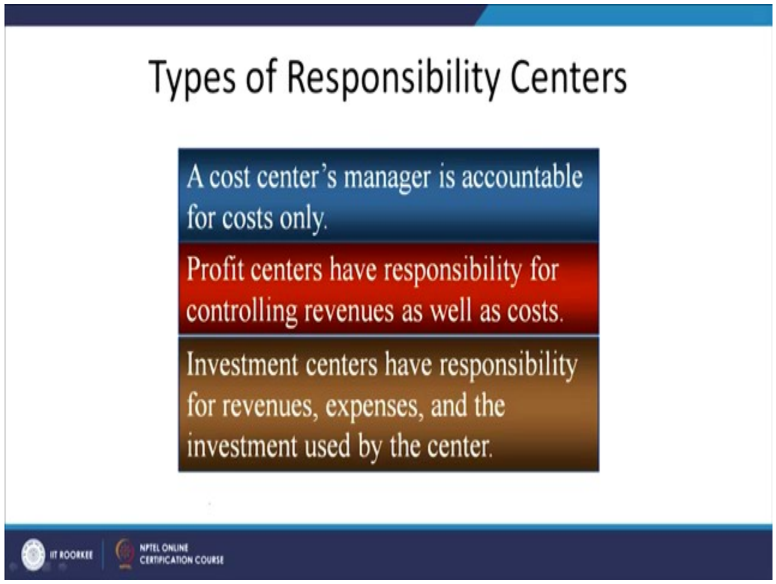

Now, type of the responsibility centers. I already told you in abstract that there are the three types of the responsibility centers. One is the cost center and the cost manager of the cost center is responsible for this responsibility center. Second is the profit center. Cost center is which means the different centers which are responsible for the inputs in the organization, right. Different inputs in the organization and then profit center means, who are responsible for taking the output from the place of production to the place of sales in the market that is known as profit centers, right; and investments centers have responsibility for revenues, expenses and investments used by the center.

So cost center manager is accountable for costs only. Profit center's managers have the responsibility for controlling revenues as well as the costs, both; because revenue also has to be kept under control means, up to the mark and cost has to be kept under control so it means ultimately you can make sure that the profit is there. And the investment centers are much larger which take care of your revenues, your expenses, your investments in whole.

Largely, we talk about how much how to improve the overall performance of the company or overall distribution and manufacturing process of the company, and what important relevant investment is required to be made, that investment has to be made sure and investment centers keep on identifying different say, possibilities where the different avenues can be found out and investments can be made. For the, say well functioning of the organization, right and profit centers compare the revenues with the cost and the cost centers are only responsible for the input cost which is required to incur for say, having a say, the product means giving a shape to the product or manufacturing the product.

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Then is the, we talk about now the measures of performance. After this responsibility centers and accounting we talk about the measures of the performance and different measures of the performance are; first of all let's understand, what are the measures of performance? Good performance measures will relate to the goals of the organization. Good performance measures will relate to the goals of the organization, balance long-term and the short-term concerns. Performance means is, achieving the short term performance and making sure achieving the long term performance. Reflects the management of key actions and activities. Be readily understood by the employees.

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Good performance measures will relate to the goals of the organization, balance long term and short-term concerns, reflect the management of key actions and activities, be readily understood by the employees. So different performance measures, how what type of the raw material we have to buy, from where we have to buy, what should be the quality of the material, what should be the price we paying for the per unit of the material.

Then in the manufacturing process, how this manufacturing has to be done, what should be the quality of the production and then how to sell it in the market so that it reaches to the maximum number of the people, within no time, within the lesser cost and all other kind of things, right. So different performance measures have to be identified for the different purposes.

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Be affected by actions of managers and employees, be used in evaluating and rewarding managers and employees, be responsibly reasonably objective and easily measured and be used consistently and regularly. They are some more features of the performance measures. Different performance measures which we are identifying, which we are going to use and work out they are, different like, they have the different features also that they should be affected by managers and employees, we used in evaluating and rewarding managers and employees, we (res) reasonably objective and easily measured and we used consistently and regularly.

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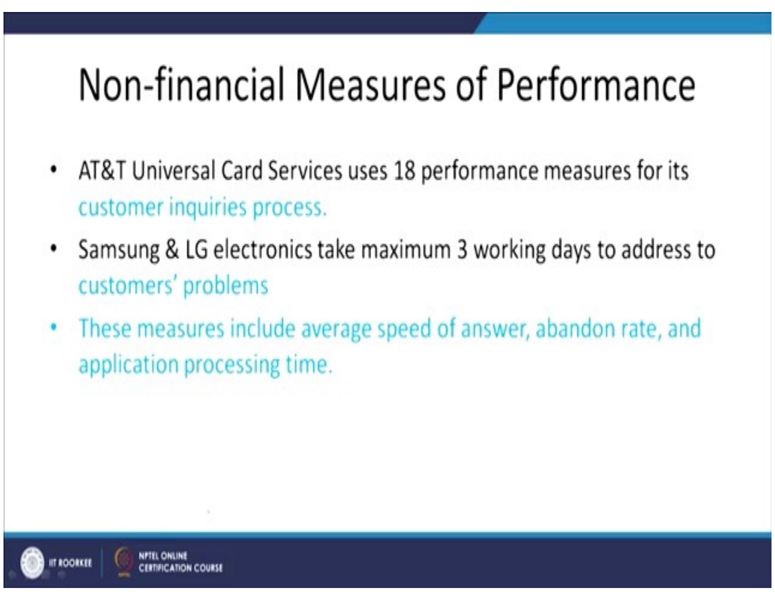

And then we have some, say you can call it as non-financial measures. Non-financial measures are basically means, when you talk about the, because total measures you can divide into financial and non-financial. Financial measures are related to the investment, they are related to the cost, they are related to the profits, right; and ultimate objective is how much investment we had made what was the cost of making that production or generating the service, how much return has come back to us. All those measures which ensure the maximization of the output, they are called as the financial measures.

Apart from that there has to be some non-financial measures also and non-financial measures are in terms of the quality of the service. After sale service to the customers, efficacy and efficiency of the distribution process to the people. So It is not only our job to manufacture, sell the product, pass the service on to the people and take the money back from them and not to care for them after the sale of the product or the service. No, that has not to be. It has to be continuous in the regular process.

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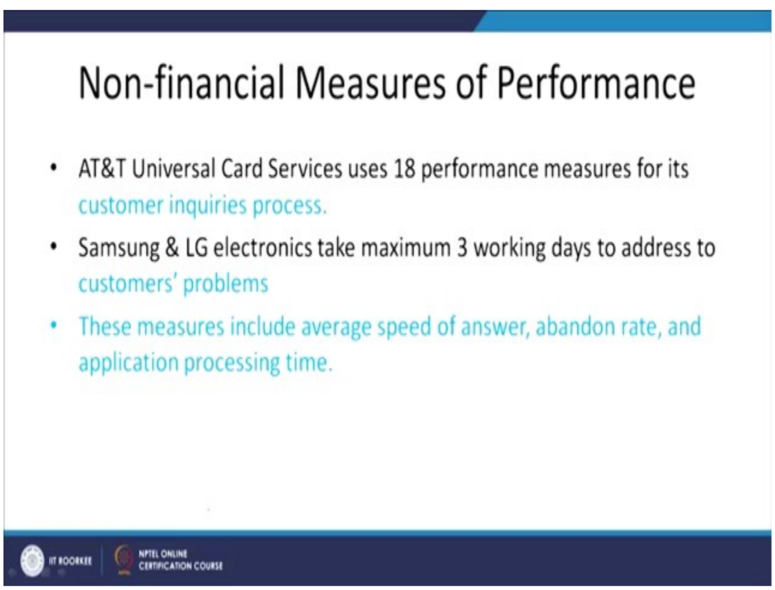

So some after sale measures are equally important, for example, we have given some examples here. AT& T universal card company uses eighteen performance measures for it is customer inquiries process. This is a telecommunication company in US, and they've used the different eighteen measures for keeping their say, customers satisfied and keeping their customers means happy and delivering them value.

Similarly, Samsung and LG Electronics take minimum three working days, maximum three working days to address to the customers' problems, maximum three working days in the farthest area. For example if somebody has purchased a color TV from Delhi and that TV is being used in the remotest part of India then reaching up to that place, a person when the product is not working up to the mark, if it requires a service, if it requires the say checking up by the company or the company's representative, when you lodge the complaint on the electronic complaints system then the person maximum time within any part of the country, they reach within three days. And in the local areas, in the urban areas, in the semi-urban areas they reach within a few hours.

So you might have seen now after this say, multi-national culture in India, the customer service has certainly improved. Earlier there was a situation, if you buy an electronic product, maybe a color TV or refrigerator, washing machine and if it gets out of order then nobody is there to listen to you. The seller will not listen to you, there is no proper service center available of the company and there is no means, at the company level there is nobody to hear you. So either you have to throw the product or you have to shell out extra money to get it repaired by the same person who has sold it to you.

But now, in this multinational culture what they have done is, they have divided the two things. One is, sales are the different, somebody else will sell the product in the market, they are the distribution and dealers of the companies. Service is totally different, service outlets are given to some private, say company's private individuals under the proper specifications by the company. So when you buy a product and if develops some problem, if you want to say, get it corrected or repaired there is one say, toll free number customer care toll free number. You simply make a call on that number.

So the seller does not pick the call, the service center pick the call and service center people tell 'Okay, what is the problem? Where the product is within warranty or within outside the warranty? And whatever the best possible we can do.' So you have not to worry about. It means what this all is, why they are doing, why they are taking so much good care of their customer because they want to perform as best in the market. They are not to only perform in India but in the all parts of the world.

So customer service has improved and two responsibility centers have been created. One is the sales center and another is the after sales center. So it means in both the cases, after sale service centers, in both the cases, people are satisfied. Right, so these are the electronics companies. Even other companies also, you might have seen there. Now, for example, now the culture has come to India that these multinational car manufacturing companies if they sell some number of cars and some that lot of cars develop a, say, some manufacturing defect. So even sometime the customer doesn't know it that some defect is there in my car but the company knows it, that in this entire lot some defect is there and they recall all the vehicles back from the market.

They pay them for sending the vehicle back, they pay for the petrol, they repair the defect means, the free of cost and they keep the customer informed that in future also if there is any problem, any defect comes up, we will be here to serve you, to assist you. So it means, this all is what? This is a culture of serving the customer better. Considering the customer as your boss and overall improving the performance of the organization as a whole. So it means this is one sort of the performance measure or say, ensuring the management controlled system.

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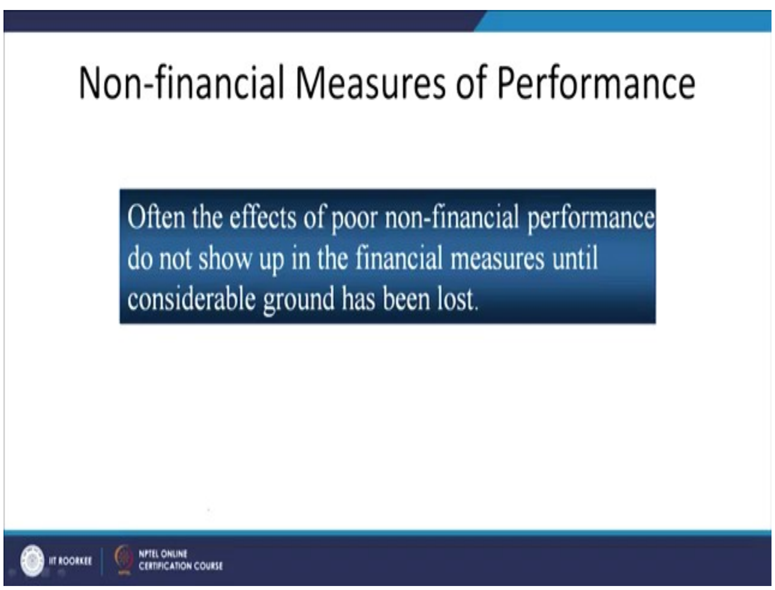

Then, non-financial measures. Often the effects of poor non-financial performance do not show up in the financial measures until considerable ground has been lost. If for example we are selling the product in the market but we are not taking care of our customers, so what will happen? Slowly and steadily people will start getting frustrated. They may stop using the product. The news may spread in the market, that don't buy this company's product, It is not good and if it gets out of order then they are not going to take care of you. They are not going to take care of you.

So what will happen? It is basically the defect. It is basically the lack of after sales service. It is basically the lack of customer service. But the effect of that is now converting into the financial effect. Non-financial effect has the financial effect's financial causes and they are going to create the problem. So (an) at that time when we come to know and when we do the say, post mortem analysis that why this problem has come up, I think significant count has have been lost and the existing customers of the company x have already shifted to the new company or the new suppliers and they have already become the former customers of this company.

And bringing those customers back to your coffer, sometime it becomes very difficult. So we need a well defined, say well equipped performance measure and a system which is called as very effective management control system which can help us in evaluating the whole process very effectively and very carefully.

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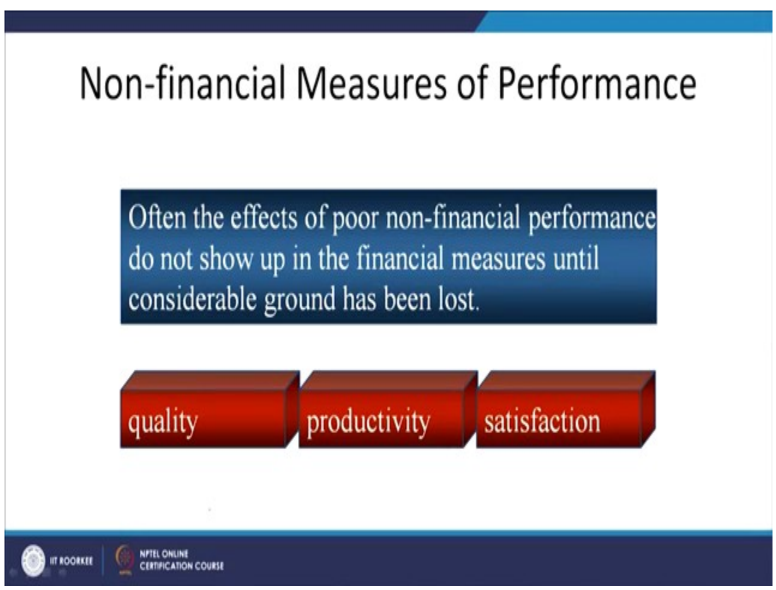

Right, and then here what we talk about is, we have to talk about that, if you want to means, be careful about your customer. If you want to ensure the effective management control system then you have to look at these three important pillars of better management control system, effective management control system, where one is the quality, second is the productivity, third is the satisfaction. Quality means that whatever the product you manufacture, that should be a quality product.

Now you see that, if you see your, means different markets in India, different products in India; you talk about any product. You talk about electronics, you talk about the electrical products, you talk about the say, your even the car industry, even you talk about the two wheelers industry, everywhere wherever we are seeing the influx of, the presence of the multinational companies it has really translated into, better quality products reaching up to the people, better quality services reaching up to the people and ultimately now because the supply side has improved. Competition in the market for the manufacturer and suppliers has gone up in the market.

So, overall emphasis of every manufacturers is on the quality. Even in the services sector, even say, mobile telephone sector you talk about. When there are the multiple players in the market, now they are very careful that your, say this voice quality is very good, your internet speed is very good, your all say communication services are very, very effective and fast and we are able to serve the customer in a best possible way. Earlier there was a department known as department of telecommunication and that department means, when they were only sole seller of the telephone facility in India.

Means, hardly they were giving any kind of the service or hardly they were means, fulfilling the customer's requirements. Today in every sector, be it manufacturing, be it services sector, everywhere you are to look for the better quality, better product and for that they are doing is, they want to keep their customers happy, they want to keep their customers say, satisfied and for that they start first with the production of the quality products because here, product is quality products. For the price which you are charging, the quality which you are delivering, there should be a match.

If you are not delivering value to the customers, you can fool a customer once or twice but not always. He will not come back to you next time and he will not listen to you or like to buy your product and this news will spread in the market very fastly. So quality is the beginning process of ensuring a very good, effective control system, management control system and it is one of the very important and non-financial measure. This is the quality.

Second is the productivity. When you improve the productivity in the organization, first effect of that comes up is the, in terms of reducing the cost of production and when the cost of production is within control, it is reduced then certainly the pricing will certainly be going down and if you are able to deliver the customer the good quality product, at a very lesser or the competitive price, in that case, your customers are satisfied, your customers are always there with you, they are loyal to the company.

So customers are also satisfied, company is also satisfied; both are in a win-win situation. So productivity when you talk about, we define productivity in terms of say, input to output ratio. For given number of inputs, in units of input, how much output we have been able to have it. So if you are manufacturing processes are efficient, if your inputs are efficient, certainly you can expect the better output. You can expect the very, very good quality output and if the output increases, quality of the output increases, price goes down then certainly, this all has happened because of the better input to output ratio and because of the better productivity in the market.

And finally, if your quality is good, if the productivity is means, up to the mark so effect of the productivity will be certainly on the quality as well as on the price. So what will happen? When you are serving your customer with the good quality products and with the say, at a very reasonable price then he is a satisfied customer. And if he is a satisfied customer, certainly you are going to reap the benefits in the longer run. So entire, this process we talk about-quality, productivity and satisfaction these are the very important performance measures and very, very strong pillars of ensuring the management control system in any organization.

Then is the, monitoring and reporting of results. Monitoring and reporting of results is that, feedback and learning at the center of management control systems. And at all points in the planning and control process, it is vital that effective communication exist among all level of the management and employees and even with the customers also. If you do not have the effective, say information measures and there is a information barrier or the communication barrier somewhere, so it means what the lower level employees want to tell to the middle level or the top level management, if It is not reaching up to them so their problems are not resolved.

And if their problems are not resolved then finally they are in a very difficult state of affairs and they're dissatisfied lot of employees and you can understand, what you can expect from a dissatisfied lot of employees, this is one. Second thing is, when you talk about the communication between the customers and the company or with the employees of the companies. Sometime companies spend huge amount to buy that information from the market research companies. How our customers feel about ourselves, how our customers feel about our products, how our customers feel about our all overall reputation in the market, that information is very, very important.

So sometimes company's own research and development divisions collect that information and sometimes, they do not do it themselves. They outsource this process and finally, they say buy this information from the market research companies who keep on, say collecting the information about the success of failure of the different products and services in the market or the products and services of the different companies and that information is very, very useful to the company for implementing the important decisions in the organization.

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Then we talk about the, say successful organizations and measures of achievements, a successful organization and measures of achievements. Now this pyramid is going to help you to understand that what is a successful organization and what are the important measures of achieving those different say, organizational objectives.

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Now first of all, we start with the organizational learning. This is the biggest means, the strongest part here, strongest pillar here and organizational learning is the base of any improvement or any say, effective control system or the control measures to be put in place in any organization. So it means we have to keep on say, training our employees, looking at the turnover and then staff satisfaction scores are important here. First of all, you have to keep your internal stakeholders within the company, within the organization very much satisfied. We have two important stakeholders, internals and externals.

Internal stakeholders are your employees, your suppliers, your even the middle level management and even your, you can call it as say, some consultants also who perform some part internally within the organization. If they all are satisfied, your suppliers are satisfied who is supplying the input to you, raw material to you, he is getting paid on time, he is getting paid properly as per the pre agreed terms and conditions, fine. If your employees are being taken care of in every respect, they are being properly trained, they are being properly given all kind of benefits, they will remain motivated.

Similarly, you talk about the say, your turnover, overall turnover that by setting up the targets and then say, giving the best inputs and measuring the performance in terms of the total production and regularly taking care of that input, output relationship and the productivity relationship, that will be the another important thing. And staff satisfaction score, calculating the staff satisfaction score is another thing. So if you are able to means broad this strengthen this the broadest component of your this pyramid, then what is going to happen?

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There is going to be the next impact of that and that impact is terms of the business processing improvements. Business process improvements, their business processes are going to improve. Your cycle time is going to go down, your defects are going to go down and your activity costs are going to go down. They are going to remain under control. So you spent money on the first pillar, on the first foundation level, so you found the improved results at the second level. So whatever the extra funds we have invested at the first level, that had delivered the results at the second level and your business processes have improved.

Then, once your business processes are improved, your product coming out of your organization is the best one, the price of that product is best one, if the after sales services is very good and when you reduce the cycle time, you remove the defects in the product and you say, keep the cost of those activities under control, all those benefits can be passed on to the customers; and when you pass on these benefits to the customers so customers remain satisfied and you can understand, a satisfied customer is the strongest pillar of any organization is the reason of the very, very good success in the market and a satisfied customer is the is the permanent, you can call it as a, call it as a support to the firm, to the organization.

Because ultimately we exist in the market for our customers and if our customers are not happy, if the customers are not satisfied then ultimately the basic purpose of that organization remaining into distance is defeated. So we are starting with learning in the organization, implementing that learning process then we are, say translating that into the improved business processes and then we are going for achieving the customer satisfaction. And then, once these three pillars are very, very strong and you call it as, strengthened then finally the overall financial strengths means, overall that translates into the financial, better financial performance of the organization and the financial strength of the company improves in terms of the product profitability and earning before interest and tax.

So, ultimate objective of every organization, very firm is that we will have to, keep on doing best at our level, producing the best product, generating the best service and then finally, giving the best output, best product at very, very competitive price to the customers. So if you do this it means you have been able to put in place a very good, very effective management control system and as a result of that, your customers are satisfied, your employees are satisfied. So the performance is the best, product is the best, service is the best and overall, your sales will be maximized, markets served will be maximized and overall strength of the organization will improve.

That will translate into the better, improved financial performance in terms of, increased sales, increased say, reduction in the cost and improvement in the profits of the organization and when the organization's profitability improves, while working on a very, very ethical systems then overall performance of the organization goes up.

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So now we will talk about something, the next technique which is given to us by a very, very famous Harvard professor, professor Robert Kaplan and he has suggested one more technique of ensuring the management control system that, technique is of the balanced scorecard. This technique is of the balanced balances scorecard. It means for every organization there has to be a scorecard, we have to have the different means the, say areas of performance identified and we have to keep on evaluating our performance measures and we have to give some marks to all the measures and finally, we have to find out the score of our organization. That is called as a balanced scorecard means, everything has to be given the desired importance, the deserving importance. If you give that desired importance or deserving importance then certainly, your organization performance is going to remain the balanced.

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So, balanced scorecard is a performance measurement and reporting system that strikes a balance between the financial and non-financial, means operating measures. It links performance to rewards. It links performance to the rewards and it gives explicit recognition to the say, diversity of organizational goals. So three important things, a balanced scored is a performance measurement and reporting system that strikes a balance between the financial and non-financial means, operating measures. Both are important, financial measures are important, non-financial measures are also important and it gives a equal importance to both, right. Because if your production is better and your means, the production is better, certainly the cost will be under control and selling price will be under control. So both financial and non-financial measures are important.

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It links performance to rewards and if the overall performance improves, we certainly can reward our employees, people who responsible for giving us the better and improved output. And it gives explicit recognition to the diversity of the organizational goals. We have different goals, best production, quality production, selling it to the people to the maximum possible extent and then is giving the best after sale service to the people and if you are able to achieve all those multiple linked and interlinked objectives and goals then finally what we are going to do?

We are going to have a very successful organization in terms of all its stakeholders, internal and external, everybody is satisfied, everybody is happy with the performance of the company and everybody is feeling blessed by working with that organization, right. So just, I have started discussion on the balanced scorecard. So what the balanced scorecard is, how it looks like, how we can create the balanced scorecard, what are the different performance measures and what the different important other aspects of the scorecards that I will discuss with you in the next class. Thank you very much.