Management Accounting
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Lecture: 59
Implementation of Management Control System - I

Welcome all! So we are now talking about the management control system in the last leg of this discussion, on this subject. Today is the second last class and I would like to discuss certain more concepts about ensuring or say, implementing the management control system in any business organization or any firm. So we talked certain things in the previous classes, in the previous two classes, I'll started talking to you about this, say very important requirement or maybe the say, the technique of management control system or the number of techniques.

So now we'll talk this discussion forward and I'll discuss it in more say, techniques or concepts which can be used for ensuring the proper management control systems in the business organizations. So in the previous class I just started talking to you about the balance scorecard, right?

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Balance scorecard as I told you earlier that is given by, is discovered by a very renowned Harvard professor, Professor Robert Kaplan and he says that see, every organization has to prepare a scorecard, striking a balance between the financial and the non-financial or the operating say, performance of the organization. And they should try to find out that means, taking into consideration or say, means considering the operating performance of the organization how the financial results have means, been or how this operating performance has been reflected in terms of the financial results. So we have to strike a balance between the operating and the financial results.

So he developed this concept of the balanced scorecard that every firm must prepare this balanced scorecard and then they should try to evaluate their own organization so that, means what is operating performance, what is the financial performance, what is the inter linkage between the two, that is something important here and we should, means prepare this card for the organizations. So how it is, means it goes ahead or it works like, a balanced scorecard is a performance measurement and reporting system that strikes a balance between the financial and operating measures, right.

What are the financial measures taken by the firm in terms of the cost reduction, in terms of revenue increase, in terms of the say, non operating incomes and then operating measures, that is efficiency in achieving the cost reduction and maybe improving the say, operational performance of the organization because if you see the overall performance of the organization, it can be divided into two broad components. One is the operating performance and second is the financial performance of the organization. So we have to see here that if the operating performance of the organization of the of any organization or a firm is better, maybe the financial performance is not better at the moment but you can say that because of very strong and effective operational performance, financial performance will improve, right.

But if the reverse is happening that say, financial performance is good, at the moment but the operating performance is not good so it means it's an indication that a weak operating structure will soon kill the strong financial structure of the company. So it means there has to be a balance. If there is any improvement in the operations of the company, that must be reflected in the financial results, and we should make sure all the times by striking balance between the two and exercise the proper control in the firm or in the organizations.

Second he says, it links performance to rewards and if we have improved the performance, certainly the people should be rewarded. People who are responsible for that improved performance, they must be rewarded. It gives explicit recognition to the diversity of the organizational goals, right, because they are the multiple goals of the organization. It’s not a one single goal that, we are a business firm so we have to only maximize the value of the firm or earn the profits only, no.

We have many stakeholders and satisfaction of all the stakeholders is important is must for all of us. So taking everybody along in the form of a team, where internal stakeholders like your employees, like your maybe the, say, the middle level management or maybe the, even the say, lower level management or the employees must be very happy in the organization and they must feel encouraged, as and when they do something good for the organization. And even all the external stakeholders, whether you talk about the say, financial institutions or maybe the investors or maybe the, say your suppliers or maybe even the government authorities, everybody must be happy with the organization.

So it means we have to, say, means recognizing the performance of the internal stakeholders especially, we must means, reward them and that is only possible if you create the balanced scorecard. It gives explicit recognition to the diversity organization goals, so it means that organization goals, which are diverse in nature that satisfaction of all the stakeholders.

Certainly we want to earn the profits, certainly we want to maximize the value of the firm but we have to improve the product quality also, we have to improve the distribution system also, we have to improve the after sale service also and we have to improve the overall production process also. So it means, there are the different goals in the organization and we should take care of all and if we do that I think we are, means running the affairs of the business in a very, very controlled manner.

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Further about the balances scorecard is, the scorecard measures an organization's performance from four key perspectives, right. Organizational learning, business process improvements, customer satisfaction and financial strengths. Organizational learning, first of all, learning process is continuous. Organization must learn from its own operations, from the external changes happening in the environment, in the industry as a whole the changes taking place and in the business world as a whole changes taking place. So, means we should create an organization, we should create a firm which is a sort of learning organization because every time if there is scope for the improvement, why not to learn it and implement it, right. So this is the first important thing.

Business process improvements, once you learn new things, that how to manufacture the good quality products, how to pass it on to the customers, how to improve the after sale service, how to take care of your employees, your suppliers, your investors, your, say shareholders, everything is important here. So, means that learning should be reflecting into the improvement of the business processes or the business operations, right and if that happens then certainly your customers will be satisfied and if the customers are satisfied, because ultimately they are the boss, they are the king. So if our king is satisfied, if they are satisfied, if the boss is satisfied then certainly you have the reasons to stay in the market and to go ahead with the business.

So ultimately what will happen, because of your better operating performance, your customer satisfaction is at the maximum and because your customers are satisfied lot, they will keep on continue supporting the organization. So certainly your financial strengths will improve in terms of improved sales, reduced cost and the improved profitability as a whole, maybe and finally the overall value of the firm will go up. So this is the structure of the balanced scorecard.

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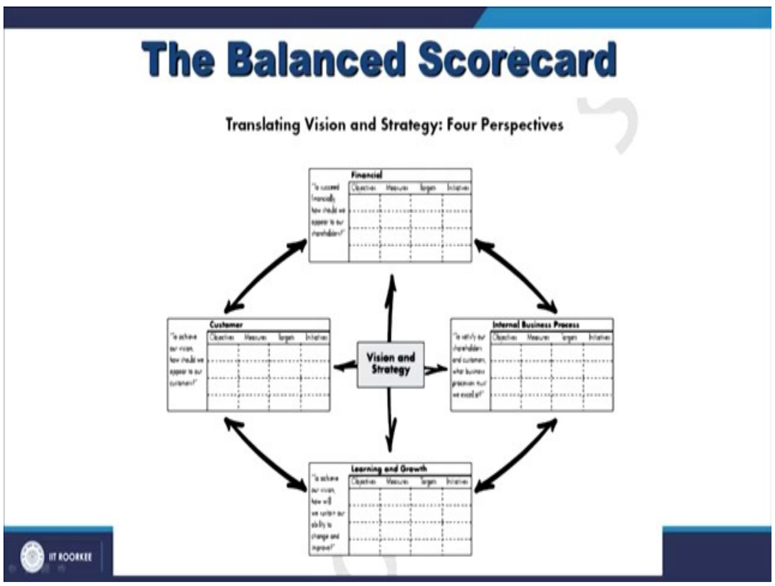

In this structure of the balances scorecard if you see that we have the four important say, components of this balanced scorecard and first thing is, if you look at this, we have the learning and growth, right. This is the first part, say learning and growth. So, it means in every area, in all the four concepts here the four sub components are there. First one is objectives, then is the measures then is the targets and then is the initiatives. Everywhere, in all the four if you see, these things are given here.

So first of all you have to set the objective here that, as a learning organization what you want to do. Means, you want to learn in every respect and all eyes, earns and say, mind of the organization or the stakeholders of the organization is open and then, means all our eyes, ears and mind are open and that we want to learn every time and for that we have to develop some measures that how we will achieve this objective or continuous learning; that we will allow our employees to go for the different conferences, to say have the regular dialogue with our distributors and our channels of distributions.

If possible then try to reach up to the customers and try to take their feedback and maybe, any other measure can be adopted and then fix up the target. That, say, how we want to say, learn and what new things we will learn and implement in the organization. At least we are able to learn and implement even a one thing in the whole of the year, that would be really much better, right and for that we have to take the initiatives, right.

On the basis of that learning, on the basis of that say, targets what we have learned is, you should take new initiatives and try to come out with the new products, new services, new distribution system, new packaging and new after sale service techniques. Then after that we talk about the internal business improvements. So we are moving this way, internal business improvements on the one side, because financial sorry, learning and growth that takes you to the internal business improvement. On the other hand when the say, internal business improvement is there then certainly the customers are satisfied. And again in every four say, all of these four say concepts or components, we have the again same four sub components-objectives, measures, targets and initiatives.

So we are here, learning and growth. On the basis of that improving the internal business processes and then satisfying the customers and then, overall this would lead to the financial growth of the organization. To succeed financially, how should we appear to our shareholders? Ultimately because the maximization of the value of the firm is the ultimate objective, if we are able to attain that by taking everybody along, keeping everybody's interest in mind then certainly the value of the firm will be maximized and overall, shareholders will be very, very happy and continue to support the organization.

So in this case, means when you talk about the learning and growth, we talk here about the, to achieve our vision how will we sustain our ability to change and improve? And in case of the business process improvement, to satisfy our shareholders and customers what happens, what business processes must do to excel or must do to excel at. So it means we should try to satisfy the shareholders and customers by improving the internal business processes and finally the customers. To achieve our vision, how should we appear to our customers, right? So it means these are the four important pillars of the balanced scorecard which can translate into the vision and the strategy of any organization.

If you have the better vision, if you the better, means way to look forward into the future, if you fix up the targets that I am today a say, startup, right. Five years down the line, I will become a say, a private limited company, right. I will ask the venture capital fund to leave and then to, means have the new say, sources of funding which are very competitive and very, very means, very, very cost effective. And then, after a private limited company, after five years in the next five years I will like to say, convert it into a public limited company. I will come out with an IPO and then I will take this organization to that national level and after that we will become into national company, multinational company and transnational company.

So it means that vision we have to have, means entrepreneurs' one important quality is that he should be visionary. We talk about Dhirubhai Ambani who outsmarted many companies who were existing in this country for more than two hundred years and look at the Reliance group, where they are today. So, means, there are so many factors but one important factor is vision of the Dhirubhai Ambani that he could look forward into future and because of his vision, because of his say, strategy based upon his vision apart from the business acumen, he could means create a organization which is known the Reliance Industries today.

So it means, you have to strike a balance between the operating and the financial performance and then take, by taking everybody along you have to move forward. It's a very important say management control which can be used and which can be of, which can be very, very supportive to the organizations and to the business firms. Now, next thing is key performance indicators. We have to now, say just to exercise better organizational control or management control, we have to identify some key performance indicators. We have to identify some key performance indicators. What are key performance indicators? What are the key performance indicators?

They are measures that drive the organization to achieve its goals. Key performance indicators, good quality product, right at a very, very competitive price and then, means passing on to the customers at the customer's place in a very efficient manner and giving the customer a best of the after sale service. These can be some key performance measures. Dhirubhai Ambani himself used to say, that my job as a businessman is, to create the best quality products at a very, very competitive price and pass it on to the people and if I am able to do that, I am able to achieve my organizational goals, my organizational objectives.

So we have to go for say, finding out the key performance indicators and improving first, the operating structure we can start from there. If you improve your operating structure, certainly you will improve your financial structure automatically, right. So identification of the key performance indicator is the very, very important part.

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Next thing is the, goal congruence exists, means next thing is the goal congruence. Goal congruence exists when the individuals and groups aim at the same organizational goals. One focal point, one focal point goal congruence we have to identify the key say, performance measures, right key performance indicators and working on these key performance indicators, we have to create one goal for all people concerned with that organization, all the stakeholders link to that organization that has to be one single goal overall growth of the organization with the growth of all stakeholders, right. So, that my personal can be achieved later on but first I should focus upon the organizational agenda and the organizational goals, my organization goals must come first or before my personal goals, right.

It is achieved, when employees working in their own perceived best interest, make decisions that help meet the organizational goals or the overall goals of the organization. It is achieved, when employees working in their own, perceived best interest, make decisions that help meet the overall goals of the organization, right. So, it means when employees are given that kind of say, the targets and created a situation by the organization for all the employees that whatever you do for the firm, whatever the best possible efforts you make for the better performance of this firm ultimately it is a newer benefits.

If the organization grows we all will grow, if organization grows all every stakeholders will go up and employees being the very, very important stakeholders, internal stakeholder if they get that kind of feeling that we have to work by taking the organization goal as the supreme. So, ultimately you can say that you need not to do anything maybe the punitive actions, coercive actions, maybe all the times you can keep them say motivated all the times you can keep them involved and you can all the times keep them means a person who is himself involved in settings of the target and achieving that target.

So, it means it is again a better control measure, performance measure. We have to improve the performance, there are two ways, either you can go for the coercive/punitive measures or you can go for very positive motivating and you can call it as the participating measures. So, which one is better? The better is that, we will have to create a situation which is going to be a very, very motivating, encouraging and participative situation for all the stakeholders.

So, it means ultimately all the affairs of the firm of the organization stand, controlled maybe everybody is working in the same direction. So, number one is the identification of the key performance indicators and then creating a sense where the goal congruence is the most important for all and organization goals come first and before the your say, the personal goals or the personal agenda of the employees then certainly these measures are going to be very, very important and very, very useful.

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Then the managerial efforts, right. When indicators are identified, then all the stakeholders, internal stakeholders, lower level employees, middle level employees, top level employees or the management when they are working towards achieving the organization goals and in one sense, in one way then managerial efforts should be means say sustained as well as strengthen that we have already found out what is to be done and how it is to be done, right.

We have already means set a goal which is a supreme goal for all concerned in the organization then we need the managerial efforts to initiate the process, to sustain the process and take it forward. So, again arbitrary management control can be expected. So, managerial efforts, that is exertion towards a goal or objective. We have to exert towards the say a goal or objective, we have to now start thinking about that how to achieve our objectives, how to achieve our goals and for that we need all these things.

We need planning, we need supervising, we need continuous thinking, plan it, go for execution and during execution some sort of supervision is required, so it means do that so that everybody remain involved, everybody feels, say involved in the organization and they are giving their best, their hundred percent to the firm to the organization and the same time keep on thinking, keep on thinking means that is a important component of the balance score card also that is the creation of the learning organization.

So, if you are all the times thinking, all the times you are working out in the in a way in a direction. We are people are thinking that, how to improve their performance? How to improve the organization performance? What you are going to achieve? Overall best performance and then that is the ultimate objective of the, this management control system.

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One more important aspect is motivation, keep employees motivated, is a drive, motivation is a drive for some selected goals. For some selected goals, what is our goal? When the goal congruence is there, everybody is moving in that direction, everybody is contributing in that direction, it means it creates the efforts that it is my goal, it is my organization I will achieve the goal.

So, it creates the efforts and it creates action towards that goal, it creates action towards that goal because I am motivated, I want to do something good for my organization and if I want to do something good for my organization certainly there is no need for me to ask somebody or maybe somebody will ask me that, okay you do this thing today or this is your job or this is expected from you, nothing.

You have your own interest because you are fully motivated employee, you are fully involved employee of the organization and you do not need to (look for) look forward that somebody will ask me to do something only then I will do it and then once I am self-motivated because of that culture in the organization then certainly my actions will be, means automatically coming up in that direction.

So, motivation is another important part of this your management control system. Then we talk about the control ability because certainly when we plan, we have to measure that performance that what we planned, how we executed those plan results and what is our performance. So, when you say, plan and try to find out that how means our planned objectives have been achieved, how our performance has been then we talk about controlling the affairs of the organization.

All the times because I discussed many techniques with you that, we discuss a concept of the cost sheet, we discuss the concept of the budgeting, standard costing, what all that was? That was all, all these techniques are for exercising the control in the organization. When you prepare a cost sheets, standard cost sheet, dummy cost sheet there is a means guiding force that look this should be the per unit cost of production, this is expected cost of production per unit, this is a cost sheet for the product A, B, C and D, right.

So, when that cost sheet is ready with us we have done the standards. When you prepare the budgets for the firm as a whole, this is our budgeted profit, this is our budgeted financial position, so what we are going to do? We are going to compare our actual performance against the budgeted and find out the variances and ultimately that is a measure of exercising control.

So, similarly you talk about the standard costing. In the budgets, we talk about the firm as a whole, a macro level control and in the standard costing we talk about the unit level control, product level control. So, when we means come up to the micro level, lowest level of the performance and we planned, we execute and then we compare the say, performance with the planning, we are means trying to do something which is called as controlling the affairs of the organization which is all the time must, is all the time required by all.

Control ability, controllable cost include any cost that are influence by a manager decision and actions because control is otherwise important also as I discussed with you that see, there can be two kind of the reasons for good or bad performance, right one reason, are the controllable reasons others are uncontrollable reasons. If the reasons are controllable, if the factors are controllable, why not to control them, if they are uncontrollable fine, they can say they are beyond the control, nobody can do anything.

If the power is not coming to the firm for 24 hours and if you are not able to generate the power internally then certainly we have to compromise with that only power is available for the 16 to 18 hours a day, so within that 16 to 18 hours, say period of time in a time in a day, we will be doing the best performance, we will be using our plant capacity to the best performance and we cannot do anything else, right.

So, controlling requires identifying what we can do, what we cannot do and if we can do something and we are doing that, we have to find out the reasons for why we are not doing it, right. So, controlling is finding out the, what we can control? How we can control? So, that things remain in a desired direction and overall goal achievability of the firm can be ensured. And uncontrollable cost is? Any cost, that cannot be affected by the management of a responsibility center within a given time span.

You can control, control it, if you cannot control leave it. So, that is why we divide the whole firm into the different responsibility centers that we want to fixed up the, say responsibility of a person or the people working in that responsibility center, we know that certain factors our controllable but for not control and the cost is gone up or the loss is increase or the leakage is a further gone up but certain are not controllable.

So, you can fixed up the responsibility, if the factors our controllable, reasons were controllable but we did not control them but if it is uncontrollable then we can say yes everybody is tried at it is level best in that or in the different responsibility centers but because of certain reasons it is uncontrollable factor, so it means we have to leave it those factors and try to find out either the alternatives or then do some other important measures we have to take.

So, if you are able to do all these things, if you are able to find out a the key performance indicators, if you are able to keep your employees motivated, if you are able to achieve the goal congruence and if you are able to control the affairs of the organization, as a result what will happen?

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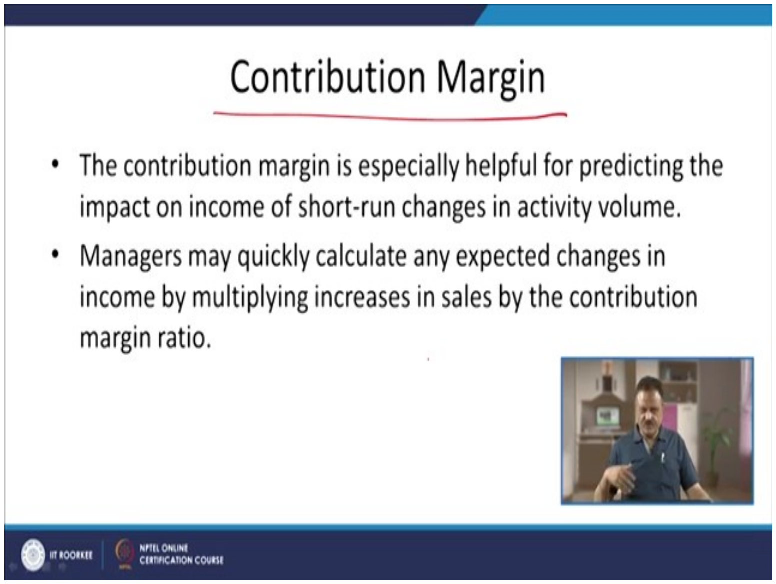

As a result there will be the improvement in the contribution margin. There will be improvement in the contribution margin because what is a contribution margin?

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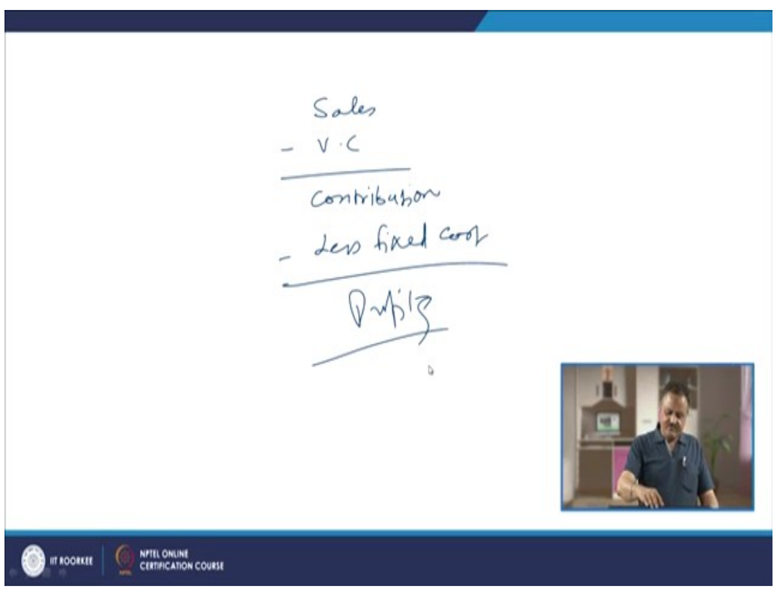

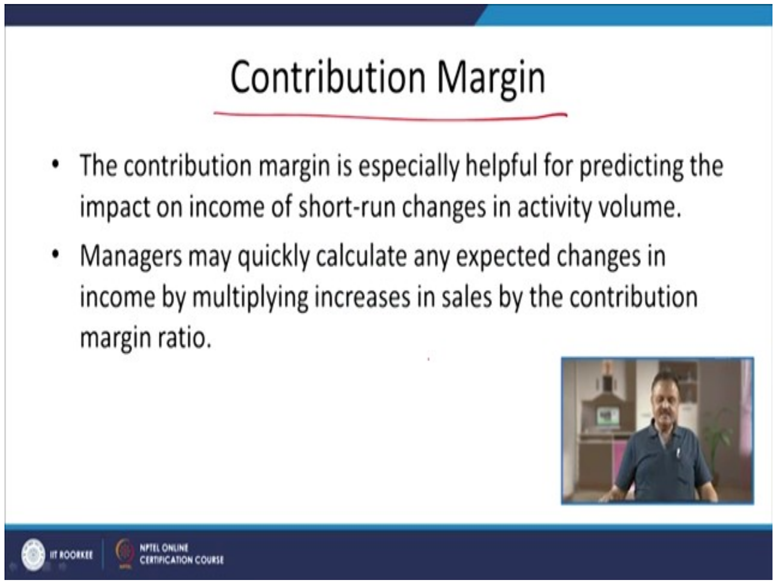

We know it that contribution margin is when you talk about the means if you recall the marginal costing, we take the sales minus variable cost, so this is a contribution margin. This is a contribution, less fixed cost when you subtract the fixed cost from this so, so you get the profits. So, ultimate objective of the organizations, is what? To improve the profitability of the firm and for improving the profitability of the firm, what we have to do here is?

We have to improve the contribution margin and if you take all the possible actions, keep the things under control then automatically it will be reflecting in terms of the improved contribution and finally improved profitability. The contribution margin is especially helpful for predicting the impact on income of short term changes in activity volume because the movement you change the production process, the movement you introduce any improvement in the production process, what is the duration of a operating cycle? Maximum a month, may be 10 days, 15 days, 20 days or 30 days.

So, if you are buying a better quality of material, if we are means buying the material at lesser price or we are making some improvement in our production process, if we are plugging the loop holes and minimizing the wastages, it will be reflecting in the better performance at the end of that operating cycle and that is going to means reflect in terms of reduce cost of production, better quality of the product and ultimately better profitability because of the increased difference between the selling price and the cost of production, so the contribution will go up.

Managers may quickly calculate any expected changes in income by multiplying increases in sales by the contribution margin or ratio. You can understand, it what proposition the contribution has changed and in what proportion that income or the profitability of the organization will change. Next thing, we will talk about is that you can implement or achieve the organizational control by say, dividing the different say or say may be following the concept of the segmentation.

Segmentation is a very, very important concept. Normally we use this concept for the market segmentation that when we are to sell our product in the market, we divide the whole market into different segments and segment can be geographical, segment can be demographic, segment can be means on any other basis. When it is geographical, you can say that entire India's market is having the four broad segments that is the northern part, northern market then it is the southern market then it is the western and eastern or may be some time fifth also the central India, so all these four or five segments are there.

Now, we have to move in a very strategic manner and to make our presence felt in all the four or five segments but in a phased manner, right. So, similarly you talk about the say, demographic segment, if you want to plan to manufacture some product, which segment of the people we want to or the potential customers we want to cover up or we want to manufacture the product far, right.

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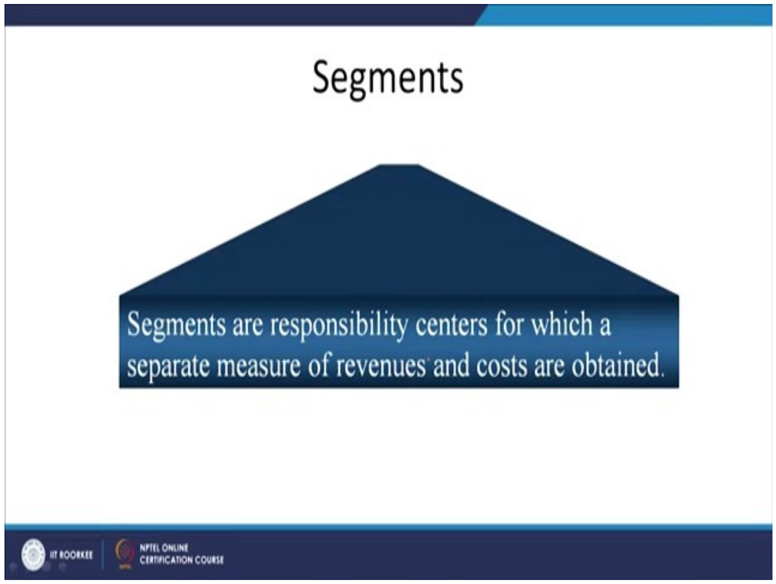

So, segmentation, segments are responsibility centers for which a separate measure of revenue and cost are obtained. We are entering in the northern India, we want to introduce the product in the northern India. Now, what is a total size of this market? How we can reach up to the people? Who are the existing competitors in the market and how we can means make our presence in the minds of the existing customers or the potential customers you have to make a strategy for that.

So, that you means you are moving in a phase manner, I will not start working in the whole countries market, I will divide it into different segments, sub segments which will be a responsibility centers for me, but for my organization and then fixing up the target for different segments, I will go ahead with the performance. So, dividing the whole firm into a different segments, you can say that you are going to achieve different targets and you are going to consider, these different segments as the different responsibility centers.

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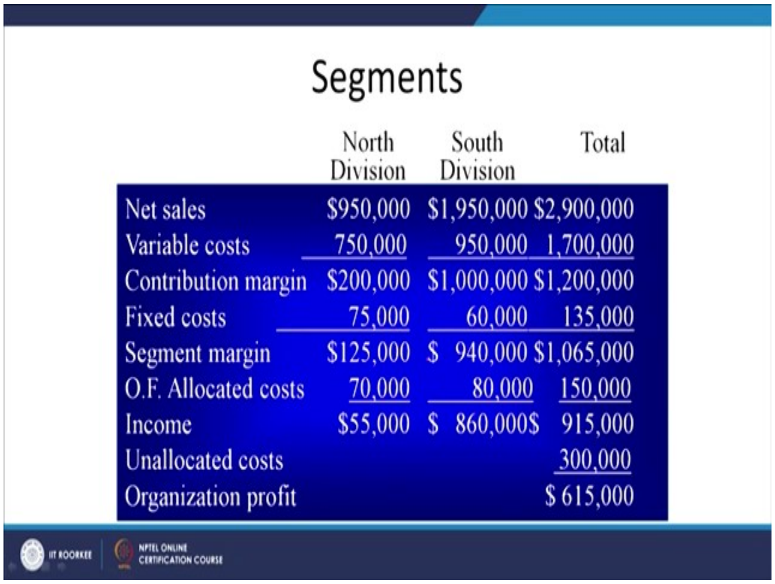

Segments

	North Division	South Division	Total
Net sales	$950,000	$1,950,000	$2,900,000
Variable costs	750,000	950,000	1,700,000
Contribution margin	$200,000	$1,000,000	$1,200,000
Fixed costs	75,000	60,000	135,000
Segment margin	$125,000	$ 940,000	$1,065,000
O.F. Allocated costs	70,000	80,000	150,000
Income	$55,000	$ 860,000	$ 915,000
Unallocated costs			300,000
Organization profit			$ 615,000

So, segments are like, we can say that we have the two segments for us currently the total market, we have the two segments, northern division, southern division, northern market of India, southern market of India and this is a total sales we are going to achieve in the coming year. We are now going to be in the other two or other three say segments of the market, I do not want to go the eastern region, I do not want to go the western region, I do not want to be largely into the central region, I will focus upon the northern part and the southern part of the country.

My sales means division wise would be this much, for example 950,000 dollars in this and 1,950,000 dollars in the southern market and finally my total performance will be this. So, you can divide the whole market into different segments and those segments can become the responsibility centers for us, we can fixed up the targets for that, we can go for the performance and execution and then finally we can try to find out that whether we will been able to achieve those targets or not, right.

So, segmentation is another process, is another way to improve the performance of any organization and every segment is a say, individual, independent responsibility centers for us and then we will try to see that how we can or what we can do to improve this performance of every segment, every responsibility center. Next, means a series of the measures for implementing the management control are say quality control measures.

What are the quality control measures? How we can implement them and how we can say, make sure that by improving the quality of the production, how it will be reflecting into the improved operational performance and the financial performance? I will discuss with you in the next and the last class, thank you very much!