



KANDIDAT

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PRØVE

BE-417 1 Management Control Systems

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☑ **BE-417, general information**

Course code: BE-417

Course name: Management Control Systems

Date: December 5th 2017

Duration: Four hours

Resources allowed: Norwegian-English Dictionary

Notes:

Please provide a sound, precise, structured and literature-based argument on each question.

1. Section: Please try to limit yourself to on average of approx. 250 words per question

2. Section: Please try to limit yourself to on average of approx. 500 words per question

Good Luck!

The professors sometimes ask for exam answers to be used for teaching purposes, but in order for this to take place, the university needs your consent.

Do you grant the University of Agder permission such permission?

Select one alternative

Yes

No

Besvart.

1 Section 1, question 1

What type of controls are becoming more prevalent in organizations and society?

Discuss how and why.

Fill in your answer here

There are many types of controls a firm might implement in order to deal with the challenges of management control and get the people to behave in a desired way and in the best interest of the firm. We have action, results, personnel and cultural control which the firm can implement if it can not use the avoidance strategies to deal with the problems.

Action control are the most direct form of control because it focus on the employees whom the organization depends on to focus directly on their behavior. It consist of behavior constraints, preaction review, action accountability and redundancy. It is implemented by observing and learning from each other.

Personnel control is the nature of employees where they can control themselves in order to give the desired outcome for the firm. Self-control, motivation, ethics, morality are all reason why personnel control will work in firms. They are implementet through selction and placement (for instance, checking referances, and getting the right people), training (having training programs to improve the skills of the employees), and job design (designing the job that motvates the people for instance).

Cultural control consist of the people in the organization having a culture where they see each other and can learn from each other, with the right values and norms. It is implemented by the codes of conduct, which says what is expected from the employees, group rewards, tone at the top and physical and social arrangements.

We can define Cultural and Personnel controls as soft controls. Due to the rapid changing environment it has become more useful to focus on the soft controls. It is also said that the soft control can strengthen the hard control like results control. Before it was a much more need for hard control, but as time has changed and it has been a greater need for having a firm that can respond quicly to changes and adapt, it is very important to have a fondation in the organization that relies on a good culture that emphasis on the accepted norms and values. We can see after the financial crisis of 2008, it is a greater need that people stay togheter and work trough the tough times. If they have strong ties among their employees they can become more ready to tackle the challenges. Also the organization has changes and has becomed more flatter and leaner. The results control with hierarchies and action controls system like burecarites, has been breack up, and replaced with empowerd employees. Before there where more like a top manager that decided the though descisions, but it has been a greater need to decentralized the power out to the company and then it is very cruical for the firm to have people who can control them selves (personnel control) because of the motivation it gives to do better and a good cultural environment.

Besvart.

2 Section 1, question 2

Discuss the problems of using the measure gross profit (GP) instead of sales volume as a goal for sales reps.

Outline why companies still prefer GP as a measure?

Fill in your answer here

Gross profit (GP) reveals how much money is left after deducting for cost related to the sales of the products. It is a widely used measurement tool and KPI among companies. However there might be some complications when the organization solely relies on it.

Let's take, office solution as an example. Here the sales reps were measured on the sales volume, how much they were able to sell of office supply. From a sales reps perspective he would think it is unfair to only be measured on GP because this is out of his control, he cannot have any influence on the price level of the product nor the demand of the product. However, from the top-management perspective, the goal of the company is to earn profit and this is in conflict with only basing the rewards on sales volume. As we can see here we have a goal-interest-of-conflict, where there is a mismatch between the individual goal and the company goal. Having sales volume might be more motivational for the sales reps, because this is something he has control over and can influence. However, sales volume also has some disadvantages, because it can create an excessive focus on short-term thinking, where the only thing you think about is reaching the target, for instance getting the 15 sales of the month target. It is important that they also emphasize on the long term goal which is crucial for the survival of the firm.

It looks like if the firm should base the compensation or rewards on the sales volume, because it will be more fair from the sales reps perspective. Where they get the benefit of highly motivated employees. However, why do so many companies still prefer GP as a measurement? The firm's owners are at the bottom line, interested in earning profit and have a good GP to look into, this is what they can show when they look at how the business is doing on the financial statement. It is also away of the company to share the risk among the employees, because an incentive is expensive and if they use only sales volume sometimes this might not give the right picture. Because you might have many sales, but they are quite small and some of less value, and a big sales that gives out a lot of profit for the firm. However, there needs to be a balance, and even though the firm still prefers GP as a measurement, it could benefit the company to also have some incentives like sales volume in addition.

Besvart.

3 Section 1, question 3

Should firms drop all non-compensation related controls?
Make a sound argument based on Merchant/Van der Stede.

Fill in your answer here

If you want to drop all non-compensation related controls and rather have an incentive system we can look at the compensation of Pay-for-Performance. This incentive says that you get paid for what you perform. You will have a higher payment for the more risk you bear, this is common in sales jobs where you often have a low salary and it is possible to make high commission. This incentive is monetary based and it relies on the extrinsic motivation. It is said that the extrinsic motivation can remove the intrinsic motivation (the joy of having a good work environment, that you get motivated by the people around you), it can crush creativity, diminish the performance and the overall performance, where it only could focus on the short term goals and therefore jeopardized the outlook for longterm goal which is crucial for the survival of the company. When having the incentive scheme like pay-for-performance you might also attract "gold diggers" that are only after the money and not creating long term value for the firm.

After the financial crisis it revealed that having bonuses and other financial related incentives made a poorly impact on most firms. For instance, in the Raven Capital, they were used to have good bonuses, and the firm did well. However, in times like the financial crisis, not many hedge fund survived and many employees were disappointed when they did not get a bonus. It is like the chief of Handelsbanken said: "It does not make sense to give out bonuses in good time, and in bad times expected the employees to work more for less than 30%". If the bonuses are not made variable with the performance it will have problems in bad time, like the financial crisis. Therefore it might be good for the company to have an incentive system that not only solely relies on the monetary incentives.

We can also look at the extreme example of Morning Star, which chose to drop all compensation. They have a quite radical model, with no boss, everyone was treated equal and it was fair, where people negotiated peer-to-peer. They dropped the compensation plan because it is expensive. Then they also got rid of the freerider problem that is sometimes included having a compensation based on group reward for instance. However this radical model might not work everywhere and it could be difficult to recruit people, because it is a time-consuming process of finding the right people.

It is said that it is better to **not** have an incentive system rather than a poorly made incentive system that makes people do the wrong thing and destroy the value of the company. If you want to drop all non-incentive controls and rather have an incentive system then it needs to give employees motivation, be informative and fair. It might be a combination of monetary (bonuses) and non-monetary (promotion), but it has to be what the employees see as valuable. And the benefit of having the incentive cannot exceed the cost of implementing it. Therefore you need to look at the business to see if it is better to have a compensation incentive or not. Sometimes it is good to drop all non-compensation related controls and sometimes it is better to have incentives.

Besvart.

4 Section 1, question 4

Discuss the management control challenges in not for profit organizations incl. public sector and provide an example each.

Fill in your answer here

The difference between a not for profit organization (NPO) and a for-profit organization does not lie in how much profit they can generate, however it is how it is distributed. Therefore the primary characteristic of a NPO is its purpose: mission or goal.

It could be hard to implement management control in NPO because the goals are more vague and difficult to measure compared to the for-profit organization. They are dependent on donors that give them money in order to operate further. And these donors can be quite demanding and have a lot to say. Even though the NPO does not have to answer to a group of shareholders and shareowners, they have to answer to the donors and they have a more higher standard, because some donors want something to say how and where the money should be distributed. For instance, a museum (which is for the public benefit) is an example of a NPO and might have some donors that have different ideas on how it should be managed, some want it to have exclusive arts while others want them to be more friendly for kids to come play and look at the art. Therefore it is hard to satisfy both groups.

The NPOs also have a higher standard when they are measured. For instance VG (Norwegian newspaper) just revealed that the charity organization Røde Kors had lied about their donation regarding Haiti. They said they had built some hospitals and provided bloodbanks in their financial statement, which was not true. (this is an example of gamenships, data manipulation). They are now being held accountable for their action, and it can destroy their reputation among their donors. And it is also sad for the people who work voluntarily. This shows that it is a great need for good management control systems to not do gamenships and act in the organization's purpose, where the mission is to make the world a better place, by helping the people in need.

It might also be more difficult to measure KPI (Key performance indicators) regarding a NPO. It is more easier for a for-profit because then they look at the financial numbers and compare it towards the profit made. The NPO does not have an outside equity interest like the for-profit organization, and therefore the KPI will be different. If we take hospitals as an example of NPO. It could be quite hard to define what is a good KPI. For instance if the goal is to improve the life quality of people. And the managers of the hospital want to have a number that shows they are helping a lot of people while being efficient and good at their jobs. Therefore they look at the number of how many people stay at the hospital overnight. It is not sufficient to conclude that a high number of people staying over and getting out of the hospital is showing that the life quality is getting better. Because then the doctors might be rushed to hit their targets of helping people and then sending them home earlier, in order to have a good KPI. To put it on the edge, this could result in death and more management control problems.

Therefore it is a challenge of implementing an effective management control system among NPO, because they need to consider several difficulties, like measuring performance (KPI) and identifying goals.

Besvart.

5 Section 2, question 1

Explain the lever of control framework, discuss its use regarding performance management and provide an example.

Fill in your answer here

Performance management includes the activities that ensure that the goal is being met in an efficient and effective manner. It is an ongoing process, with communication between the supervisor and the employees throughout the year and it focuses on reaching the goals the organization sets. The communication process consists of setting objectives, identifying goals, providing feedback and reviewing results.

In performance management we can use the lever of control framework as a tool to get the desired outcome. The lever of control framework consists of, diagnostic controls, boundary systems, interactive controls and belief systems. The diagnostic controls and boundary systems are constraints while the interactive controls and belief systems are designed to develop growth in the organization. It might be hard to keep the levers up to date and to stay relevant.

In the light of this, I will look at the Henkel case.

Diagnostic controls consist of giving feedback. It involves a conversation with the supervisor and the employees to give feedback on how you are doing and how to improve.

In the Henkel case we can see that they have a Development Round table, where the employees meet with the supervisor and the HR representative for a 5-10 minute talk about how everything is going. They use the evaluation grid, which gives the employees an indication on how well he is performing (based on previous work), and how his potential in the firm.

This could be an eye opener for the employee, because he can for instance see that he needs some improvement regarding performance and then get a "kick in the but", to do better next time. On the other hand it could also be quite demotivating. For instance, Hannah was very sad after she got a S4, which means she is great at the performance, but the company doesn't see a future in here. This resulted in her leaving and the firm lost some good workforce.

Interactive control is the approach the senior manager implements in a formal meeting between the chief and the employees where they interact at all levels, it could be like a team meeting. Where they focus on one single issue. The benefit is that they can focus on the real issue, however we do not forget about the other issues, but they are just being taken over by other controls like the diagnostic controls.

In the Henkel case we can look at the interactive control as Rorsted (the new CFO of Henkel) approach to not be a "happy underperformer" anymore. He does not want to settle down and be happy for being nr 2. and 3. This is their main focus. After the financial crisis prices on the raw materials went up, and they had to sell at a higher price, meanwhile the demand for Henkel beauty products went down. This was hard times and Rorsted says that they cannot stay where they are now, they either move up or down, and they either become relevant or they become irrelevant. Therefore could their interactive control be that they constantly focus on not being a "happy underperformer" anymore at the team-meetings and aim at being nr. 1.

Boundary system is a statement that says what you cannot do in the organization.

It is hard to say what the boundary system is in the Henkel case, because there is no "you cannot do this or that". However, I can say there is some degree of boundary system. For instance when they are rated and giving an evaluation of the grid, it does not necessarily mean you will get a high score the next year even though you work just as hard. There is not a free ticket, and you need to work hard in order to get a good score, and even harder the next time. As Rorsted says, "the target is the target", either you stay and work towards achieving the targets or you leave". This might be a boundary.

Belief system articulates the mission, norms and values of the company. It is what the company believes in.

In the Henkel case, we can say that Rorsted had a mission that the company would emphasize on this purposes:

- Achieving overall business performance
- Taking care of our customer
- strengthen global teams

He wanted to have a performance-driven culture. Where he implemented 10 values that consist of goals, history and job design. The 10 values were divided into 5 to make them more specific. It is however important to mention that the values Rorsted implemented would not work all over the world, because of cultural differences it would not probably work in countries like Egypt.

There might be some issues regarding using the lever of control in Henkel. For instance, one employee who has done a very good job was fired, because he was not a team player. He did not adapt quickly enough to the changes and was fired. When implementing a new performance management system it is very important to let the employees have time to adjust and it might be an idea to implement some training programs (personnel control).

It is also important to diversify the risk, where they have 3 business lines, because if it goes bad in one of the lines, then it is better to have spread the risk, because then he still has 2 other lines to rely on.

Besvart.

6 Section 2, question 2

Please outline the functions of budgets and discuss the dilemma of setting targets at the right level.

Fill in your answer here

The budget is a written plan that show the organization where to go (objectives), how to get there (strategy) and what results can be expected (performance targets).

The purposes of the budget is to:

Planning: Meaning that the firm make a plan in advance. Employees tend to be preoccupied with their bussy day-to-day life and then it might be good to have plan to look into, to see if you are on the right track. It makes the employees think more forward, and the managers gets more information about the firms oppotuinies, threats, strengths and weakness (SWOT), as well as the gets more information about the strategy. For instance if they have a plan they could be more ready to tackle the uncertainty environment, eventhough not everything will go as they planned, but then they at least have something to realy on, and not standing with their "hat in their hand", wondering what to do next.

Coordinating: It is important to have effective and good coordination at the firm, where the managers can provide important information to each other. They could have bottom-up communication about the priorites and bottom-down communcation about the resources and opportunities. if there is lack of coordingation then it would be difficult to find the well suited targets and pursue them.

Top management oversight: Envolves that it is the top managers responsibility to create value for the firm. Top management oversight is often centralized, where the decison-making power lies at the top. This could be helpful because then the top managers can take the difficult descison and he has maybe more knowledge and experience to do so, rather than a lower manager making pore descion. It can be realted to though descions like accustions and divesment. However, it is very important that the top management meets with the lower mangers to get some more inputs on what is the best decsions (because they are closer to the customers for instance).

Motivation: it is very important to have motivation targets. The targets needs to be challenging but achivebal. If the targets are too easy or too difficult to complete it will results in very frusturated employees and lack of motivation. If the employees are not motivated they will not contribute to the desired results. We can say that the targets needs to be SMART-goals (Specific, measurable, achievebal, relevant and timely)

There are some dilemmas related to setting target. The targets setting process involves around:

Model-based: It is the prediction of performance of the upcoming periods.

Historical: It is based on the previous targets and makes an estimate for the next. For instance, it could look at the targets from last year and this can be an estimate for the upcomming year. However, we need to be careful looking at this, because if we look at the summary of the last 10 years it will not give a fully picture, due to there might be some years the targets was deviating from the normality, for instance in 2008, with the financial crisis. There when setting target it is important to remember this.

When setting targets there needs to be a **negotiation** between the top manager and the low manager. For instance the top manager wishes of having a compitive and a preformance driven company needs to be synchronised with the lower managers information of what is a realistic target. They need to meet and discuss this. For instance, could the top-manager propose an increase in sales of 10% next year, and then the lower manager could say that they also need to think about the customer satisfaction, which is also important, and then it would be more realistic to increase the sales with 5 % and think about retaining the current customers needs as well. Because in the long run having, loyal customers will benefit the firm.

Fixed vs. flexible targets

Most firms use fixed targets, which means they are staying constant. While flexible targets adjusting to the rapid changing environment. The dilemmas of having fixed targets will be that they can get out of date and that they held the top manager accountable for achiveing the targets,

eventhough uncontrollable actions occur. It is more normal to have flexible targets at lower levels, for instance the manufacturing is not being held accountable for reaching the fixed cost- budget.

Internal vs. external targets

Most firms use internal targets, meaning that they look at their historical data and compare the previous targets when they are setting new targets, to see which areas to improve. However, it is also an idea to performance external target setting like benchmarking, where you compared your selfs with a similar company or competitor and see where to improve. This is what Volvo did, comparing them selves with other car manufactors like Scania and Daimler. We can also see that Beyond budgeting might be a way of setting targets, for instance regarding benchmarking, where they compare themselves with other companies in order to long at the long term goal which is crucial for the survival of the firm and in the rolling forecast, where they are setting targets based on chaning in the environment.

Besvart.

7 Section 2, question 3

Discuss organization`s experience in implementing Beyond Budgeting (BB).

Explain the key challenges related to BB-implementation and provide an example.

Fill in your answer here

Beyond Budgeting (BB) is a process that was first implemented by the Swedish Handelsbanken in 1972. After that the model has been refined and used among many companies that look for inspiration. The purpose is to overcome the pitfalls regarding the traditional budget that has been criticized for being too time-consuming, not added value, and prohibits the manager from responding quickly to the environment.

BB is a model that gives the firm opportunity to respond quickly to the changes in environment, as well as it lower the cost of operating the firm and it attract the good and motivated workforce.

We can look at Sparebank 1 (SBI) with their experience and challenges regarding implementing BB. The journey began with them having a new CEO entering. He started asking questions of why they were doing this and that regarding the budget, and he was very inspired with the ideas of the Handelsbanken BB movement. Therefore he got rid of the budget, but as Sigurd mentions "they did not get rid of the budget to save time, it was to use the time in a better way". At some point the budget will become irrelevant.

They experienced some resistance because people experience some lack of direction, they did not understand why they were getting rid of the budget and how they could survive without it. Some employees thought that this meant they were not having a goal, and should not focus on the targets and resource allocation. Which was not true, they were separating it in order to improve them. It can be difficult to change the mindset of the employees because BB is interfering with everything they believe in and stand for. For instance in the Statoil case, there were two groups of resistance, one that were confused and did not understand, and the other who understood, but did not like it. Linking this to SBI there were also some people who did not like it, and quit. However, then they were left with highly motivated people and ready to be a part of the journey.

I can understand that some people might be afraid of "dramatic" changes, and this could for some be a little revolution, because usually they have had the budget to stick to, and it is easy to say "well at least it followed the budget, when something goes wrong". However, this is not the way to think, they need to stay proactive and be ready for the challenges. For instance after the financial crisis many companies had to recast their budgets, and that is a reason why SBI does rolling forecast, because during the year time changes. It is very important when implementing BB that the employees have a smooth transition, and that they get time to adapt. Because it could be harder to convince employees in their 50s that are used to look at the budget, and to tell them that everything they learned during their business studies needs to change. This is not a quick fix and it will take time.

SB1 has regular whiteboard meetings, where they discuss the KPI and what is important to emphasize on. The top manager of SB1 has gone from sitting in the office telling people what to do, to interacting at all levels.

It is important to remember that the bank industry does not have such a complex environment, and it might therefore be more suited to implement this kind of movement, rather than in more complex environment. However, that said, everything is possible and Statoil is in the journey of implementing it, and they have a quite complex environment with the oil prices and rapid movement. Rome was not built in one day, and this is not a quick fix, people need time to adjust and get used to the new mindset.

We can see that the BB movement is spreading in several Scandinavian countries, where the controls might get looser, however, this will probably not be suited to implement in countries like Germany, because they like to have more tight controls there.

Besvart.

8 Section 2, question 4

You work in the department of finance and control at a mid-sized company providing supplies for the oil and gas industry. Recently, many employees in the staff function have retired, therefore the group needs to take initiative in hiring new highly skilled employees for the accounting and control function. New employees should be good communicators and know the latest accounting trends. Your task is to

develop the job description as well as the tasks and requirements for a job advertisement.

Fill in your answer here

Are you over next controller?

Background information

The controller job function has changed during the recent years. From being a "bean counter" to more like a business partner. Therefore they have moved from the backoffice to the front office. It is very important that you can make the business successful by keeping up to date on the various aspects at the firm and that you have excellent communication skills. In the recent years IT has increased among our business and much of the work our former accounting employees did, like writing the invoice by hand, is now being replaced with computers and other programs like ERP. (Enterprise resource planning). This has given the controllers more time and freedom to become more as a business partner. Therefore we are seeking people who can do both roles. Where you are both responsible for the management service, where you help the line managers make important and good decisions and the other role as an oversight, where you look after the employees and see if they are behaving to the legal and norms set by the top management. Our company has been in the industry for a long time, and we always want to improve and interact with the constantly changing world.

This is a demanding task, but it enables you to have a lot of different experience. Are you able to wear two hats? Both being a team player, but also being a police officer or a watchdog.

Task and requirement

As mentioned you will have a job consisting of helping the line managers decide on important decisions. And therefore it is required that you are highly motivated, a team player and could easily adapt in difficult situations. There is also very important that you manage to stay independent of the line manager, because even though you want to be a good team player and want to please them, it is easy to get emotional or personally attached and then look the other way rather than reporting to the top. This might happen if the control is decentralized (where there is a solid line between the line manager and the controller, and a dotted line between the controller and CFO). However, you are also able to look after the financial assets of the firm where you are the person between the treasurer and the line managers. There you have to move quickly and like to respond to different tasks. Therefore there might be some situations where you have to report on your teammates because we only want the correct and accurate information reported to the top. When the controller is closer to the CFO, they have a solid line, we could say that it is more centralized (then there is a dotted line between the line manager and the controller). Even though it is easy to stay closer to the person you are working closer to, we want you to be responsible and independent and therefore fulfill both roles. This is an exciting experience and you will have a job that is not boring. This is the job for the ambitious people who aim high. We want to stay excellent and be proactive, will you join the journey?

You need to:

- Have a master degree in business and administration
- 3-5 years experience with accounting, preferred if you know how to use the ERP system
- Excellent interpersonal skills and communication skills
- Have courage and be highly motivated

Your benefits:

- Salary is competitive
- Pension benefit
- A great work environment
- An valuable experience

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