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PRØVE

BE-417 1 Management Control Systems

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Vurderingsform	Multiple choice
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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:
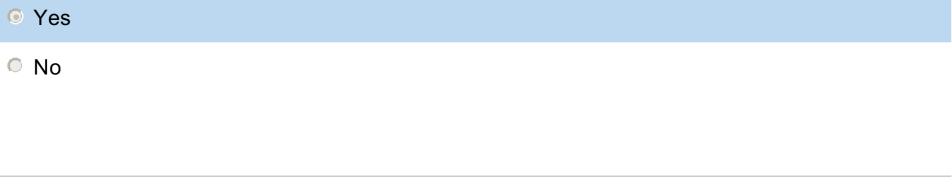*Please provide a sound, precise, structured and literature-based argument on each question.*
1. Section: Please try to limit yourself to on average of approx. 250 words per question
2. Section: Please try to limit yourself to on average of approx. 500 words per question

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 permision 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

Today, soft controls like *personnel* and *culture* control are becoming more prevalent in organizations, than hard control like result and action control. Personnel control is about self-monitoring and based on that people have a self-consience that tells the differens between right and wrong. Culture control is about feeling conntected to a certain group or team, their norms and values. It´s not easy for people to let down others in the group, because they have an emotional tie to one another.

Reasons for this change could be that bureaucracy as a form of control have been reduced, and replaced with trusting employees. Reasons for this could be that employees now have a lot more to choose between in the job market, and becuase there are more organzations supporting and working for a better work environment, like LO and NAV. A great example where it have paid to focus on better culture and personnel control, is in the giant technology firm, Google. They are known for their loose structure and uniqe culture. Employees can wear what they want to work, and they even have a nap area. Their offices looks like a adult playground rather than a work space. This helps them attract creative and innovative people who are not constraint, and that can lead them into the future.

So, it pays to be nice to the employees and satisfy their need. Another example is the giant home-decorating firm, Sears. They fount out that if employees attutude was increased, than customer satisfaction would also increase. So the whole firm would gain upon this.

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 is earning after sustracting the costs, while sales volume is the number of products/services sold.
There are two different ways to measure performance in organizations. Market and accountings measure.
Gross profit is a type of accountings measure, and the problem of using this to measure the performance of sales people, is that it does not reflect economic income perfectly, and this is why:

1) They are transaction oriented
2) They are highly dependent on the measurement method
3) They are conservatively biased
4) They ignore the cost of equity
5) They ignore some value and changes in value
6) They ignore risk and changes in risk
7) They focus on the past

In general we can say that the problem is that sales people an not be held 100 percent accountable for their performance. There are factors, like those mentioned above, that effect the result, that they can´t help. Sales people can´t control the costs, so it´s a bit unfair to use this as a measure. Also, in bad economic times, this can really hurt the motivation. When it comes to sales volume this could be a more direct way to measure performance, and the salesmen could be helt accountable for the sales. One problem with this is that the salesmen can focus to narrowly on the task and priorities quantum before quality.

However, some firms still use the measure of gross profit, this is because they feel like the advantages overweigh the disatvantages. The advantages are that they can be measured on a timely basis, are accurate, objective, and congruent with the company goal of maximizing the profit.

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

When we talk about non-compensation related controls, we talk about control systems that does not provide a reward of any kind.

I don´t think that firms should drop all non-compensation rewards, becuase there is no right answer that works for every organization. What works for some organization, might not work for others. So the answer to this question is highly relative.

Take Sparebank1 for instance. They cut all bonuses and incentives but still managed be incredibly successful.
On the other hand, take Office solution, and small office supply firm, found out that differentiating and compensating their employees based on their performance was a good thing.

The main focus should be on motivation when deciding whether to have compensation or not. Extrinisic compensation have different effects on different people. As a good manager one should know their employees and know what would work for them. For example, some people would feel like they are controlled by rewards and not respond well to extrinsic compensation, while others will feel highly motivated and work extra hard.

As a leader its important to motivate people from within, and in teori the "perfect" employee should work toward the company strategy and feel motivated when the company is successfull. But this is not reality, because people are self-centered, and tend to put their own needs in front of the organizations. So, managers that want to be good leaders should find the balance between extrinsic rewards and intrinsic rewards that match their organization.

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

A not for profit organization (NPO) play an imortant role in our society. Examples of this could be schools and hospitals in the public sector and political organizations in private sector. The difference between an NPO and a proft organization does not lie in how much profit they produce, but on the *purpose* of the organization.

The main difference between these types of organization is their difference in use of management control systems and the following challenges. For an NPO, for example in the public sector, it could be difficult to set performance targets, and often they will conflict. For example in a hospital, they can have the goal of helping the patients, but also do research. This could be conflicting for the employees, what should they priorities?

There are also challenges with the measuring of performance in NPOs, some firms find it difficult to because
it´s not always quantifiable or objective. There can aslo be a motive to conduct in gamemanship in NPOs. For example if the target is to increase the number of night patients are submittet, the doctors could have a motive to send people home before they are healty, to meet the target. NPOs also have to use different KPIs than profit organisation, they could use donor growth, fundraising ROI, numbers of helped people instead of GP.

Another challenge with NPO is external scrunity. They have to answer to the public, donors, and government (public sector). The reporting and budgeting have to me accurate. An example of how important this is, is shown by the norwegian Red cross. A few months ago the newspaper VG revieled that their reports were very inaccurate, and that nothing of what they claimed they had done, was true. (building hospitals etc. in Haiti) This kind of fraud, could have the impact to destroy the company.

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

In a fast changing environment and future uncertainty, firms use the lever of control framework to better run their businesses. In the framework the pressure of performance management from diagnostic systems are balanced with three other levers. They all have to be considered and monitored. These are:

1) *Belief systems*. This is the firms value, vision, and beliefs. What is the purpose of the organization?
2) *Boundary systems*. This is could be norms, rules, and laws that tell the employees how they can and cannot act or behave in the organization. Codes of conduct could be used to form the culture.
3) *Interactive system*. These are strategic feedback. These systems allows top manangers to have an open dialog with the employees and discuss their performance.

To provide an exampel of how this could be used to improve the perfomance management I will use the company, Henkel, from the case study´s in class.

Henkel got a new CEO, and he found some flaws in the performance management system. Henkel was seen as a happy underperformer in the market, so they wanted to change this. He wanted the company to be a "winner in every market they competed in" and the competitors to see them as a high performer.

When it came to belief systems, he wanted to change the cutlure in the organization. He wanted to create a winning cuture, and he also had 5 new values: Put **customers** in the center, trust, support and reward **employees,** grow sustainable **financial** profit, Grow the business in **sustainability**, and focus on **familiy** business traditions.

When it came to boundary systems, he had to let everyone in the company (and they had employees worldwide) know about the changes and the new belief systems. He and the managers created a 360-degree communication campaign in all major countries, via Henkels intranet, posters and town hall meetings, where the vision was discussed and presented.

And last they created interactive sysmtems that provided performance measurement, evaluation and feedback. They created the evaluation grid, that judged each employees performance and potential, and they were ranked Low, Moderate, Strong og Top (performance) and 1,2,3,4 (potential).
They also created Development roundtable, where they discussed each of the employees performance for about ten minutes. Here, the top and low managers discussed the evaluation grid, which was the base for the meeting. To push managers to take tough decisions and differentiate employees, each year they made the managers rank 5 percent of the employees L, 25 percent M, 60 percent S and 10 T. This was called the Orientation frame. Bonuses were also linked to the overall organizaiton performance, team, and individuall performance. The CEO belivied that the bonuses had the ability to increase motivation.

Henkels use of the levers of control helped them to be a winner in almost every market they competed in. The CEOs target about hitting 14 % EBIT, shocked alot of employees and shareholders, because this goal was really ambitious, but by using the levers of control regarding performance management helped him reach the goal. What I learned from the case is that it´s important to set ambitious, but achievable goals.

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

Budgets are a very important part of the management control systems. They tells the story of where the organization want to go, how they want to get there, and identifying risks. It´s about producing written plans and budgets about the future. Budgets have four different fucntions and here is an ouline:

1) *Planning.* It is very important for firms to plan the future. It will reduce uncertainty of the future, and set a ground for what the company can expect. Identifying risks are equally important. An example of how important planning and budgeting is the David Service group, a service retailer managed to be profitable despite the recession in 2008. The manager said that this was due to careful and detailed financial planning, and indentifying the potential risks.

2) *Coordination.* Budgeting provides information sharing across the organization. It allows top down communication as well as buttom up communication. Budgeting also coordination between enitiy´s and divisions. An example of this is could be that the production division is coordinated with the salesmen beacuse of budgeting, to decrease excess use of material and personnel. It also prevents misunderstandings.

3) *Management oversight.* Budgeting provides an oversight over managers. It allows a forum where top and lower managers meet and discuss the targets, planning and budgets. Often, there occurs an information asymmetry, because the top management dont have the same information as the lower. They can use negotiation to come oúp with the right targets. E.g. if the top managers want next years EBIT to be 10%, and the lower managers knows their salesmen, and knows that this is impossible, and that the salesmen will be demotivated, they can settle on 7%.

4) *Motivation.* Finally, budgets provides a motivational effect. When budgets are met, the employees will feel a self-satisfaction and happy to see their organization successfull. They could be motivated to do even better.

But setting the targets can be very diffiult for many organizations. The important question whether to be conservative or ambitious have to be answered. If its the targets are too high, this could lead to demotivation of the employees. They will feel that "it doesnt matter what I do, i will never make it" and even stop trying.
Now, if the targets are too low, the employees will make it, but they will feel that it was easy, so there is no motivational effect. So, the key is balance. Find the right level, where the targets are ambitious but achievable.
Its imprtant to link the target to the overall strategy, validating the links, set the right target, measure targets correctly.

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

In an fast-changing environment and very uncertain future, many organizations choose to use Beyond Budgeting to improve their organization. Beyond Budgeting makes it easier for organizations to adapt faster to the environment. It catches changes, improvements and flaws in the internal and external environment. Those who use BB, feels that the traditional budgeting is too rigid, and too strict. They feel like the traditional budget have to many giudelines that cannot be changed, once sat. This is not how the future is now. Big organizations like Handelsbanken, Sparebank1, Borealis and Statiols have all started using BB.

BB is one war, but a thousands battles. This means that there is no "one" way to it, the key is to find the right combination of principles and tools. BB is also not a quick fix, it more like a journey. There are different principles: goals, values, reward, accountability, etc, and different tools: balance score card, financial forecast, cash forecast, rolling forecast, benchmarking, whiteboards A3 problem solution.

The key challenges with using BB, is the fear of the uknown. Getting employees and stakeholder on board can be very challenging. Traditional budgeting is something they leaned in school, "this is the right way", and something they have always been using. So, big changes could mean resentment and fear.

Further, I will discuss the Sparebank1´s experience in implementing BB. Sparebank1´s CEO saw that there needed to be some changes, and he was very inspired by Handelsbankens success with BB. He saw that the future is not what it used to be, it was more dynamic now. So, he implemented somethin he called "Dynamic Management". This was about stronger customer position, better financial targets, and making Sparebank1 a fun and developing workenviroment. The implementaion of Dynamic Management were done though 4 projects:

1) Culture and organization: This is the only project still going. It was about creating acceptance of the changes, and change the culture in Sparebank1, such that it was congruent to the new strategy.

2) Rolling forecast: They got rid of the traditional budget and implemented a rolling forecast. They forecasted 12 months ahead, each quarter, so that the difference between forecast and reality would be miimized. The rolling forecast cought changes in the environment and allowed changes in plans.

3) Bonuses/Incentives: These were completely cut of. When perofrmance is below what is expected, motivation would go down. Besides they did not want people that only worked towards a reward.

4) Benchmarking and scorecards: The CEO said that success is not defined as outperforming yourself, but outperforming your competitors. Success is now relative, so they used benchmarking to compare themselves with other similar organizations in the market. They also used balance scorecard to map how they are in postion to customers, financial goals and internal growth and learning.

The key challenges in Sparebank1 was getting people on board. It could be a good idea to convince people that the traditional budget is dyfunctional in todays markets. Sparebank1 lost some employees that did not agree with the changes, and put alot of pressure on the top management. This could be avoided if the changes were implemented gradually, and if they provided information *before* the actual change.

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

Job description

We are a mid-sized oil and gas company, OilTech, and we are looking for a new controller/management accountant. Due to retirements, we are looking for someone to join our organizaiton and become a member of our team. In our organization the controller function is centralized, meaning that the controller will report directly to the corporate controller.

It is imortant that the potential employee have information about the controller role, and how it have been effected by the latest technology. It is also highly relevant that the employee is familiar with the Enterprice planning system (ERP), due to implementation of the system in OilTech. The controller role and job description have changed because of this. The enterprice planning system have made the job more standardized and automatized, so that the potential controller are free of duty´s like data collecting and data analysis.
This leaves the controller to have more time and resources to act as a manager partner and help the managers make good decisions.

We have experienced that the ERP system have been time consuming in the start. There will be traning and IT consultants in the start of the job, to make sure everything is in order.

Requirements

It is required that the controller have minimum of three years of experience in the field. We want highly skilled employees, and although there is a training program, we expect you to have done this kind of work before.
Skills that are requiered in the job is to be accurate and good with number, have a sense of responsibility and moral. Trust and loyalty a important focus in OilTech. Since the role is highly centralized, conflict like the entity looking at the controllers as a corporate "spy", could occur. In that case, we would want professional behaviour and someone who is good with authority. The job includes reporting numbers and information between corporate and the deparment of finance control, so communication is a key requirement for the controller.

Tasks:

The main tasks include reporting budgets to the corporate controllers. Help managers make budget and long term strategy. Advice the managers when it comes to tough decisions. The job also included tasks like making reports of the performance from the enitity of finance and control back to corporate. Finally, the controller must initiate and manage control systems.This involves creative thinking and implementing new control systems that improve performance in Oiltech.The controller will have a *fiduciary responsibility* and a *management oversight* responsibility of letting others in the organization know when employees have broken the low or norms.

Besvart.