Management Control Systems

Block

1

INTRODUCTION TO MANAGEMENT CONTROL SYSTEMS

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COURSE INTRODUCTION

The word control in an organization is generally taken as financial control. But the word "control" is closely associated with aspects like cultural behavior in work place, budgets related to functional aspects like marketing, finance etc., variances and audits. Hence the word "control" relates to all management functional areas. It is important for organizations to comply with regulatory requirements and their own ethical code besides meeting the growing expectations of multiple stakeholders on economic, social, and environmental concerns. The controlling function takes place within the organization and by implementation of land of law by regulatory agencies of the economy.

Management Control Systems deal with various control measures, tools and techniques for implementation of control within the organization.

It may be noted that effectiveness and efficiency are not merely about doing the right things and doing things right. The business environment is dynamic; competition cuts across product categories and national boundaries, and consumers are well-informed and willing to explore the choices at hand. At all levels and across all functions of the organization, excellence of execution requires double-loop learning – the habit of anticipating changes and adapting to them in a proactive manner. Often, this adaptation is simultaneously required on multiple aspects such as strategy, structure, systems, and culture. And such adaptation is required both for guarding against possible declines in an organization's performance and for gaining competitive advantage.

In the course on Management Control Systems, we take an integrated approach to performance and compliance. We look at organizations as open systems where people in different functional areas use resources to perform a variety of activities that result in outputs and outcomes that satisfy stakeholders and realize the organization's objectives, while complying with the law and adhering to ethical principles. Therefore, to ensure that the organization achieves its objectives, management control has to address all its sub-systems. Management control thus has four broad objectives – effectiveness, efficiency, disclosure, and compliance.

In this course, in addition to the underlying concepts and techniques of management, we discuss its applications in different contexts (such as in international business and service organizations) and in different functional areas.

This edition has added a large number of contemporary examples.

BLOCK 1: INTRODUCTION TO MANAGEMENT CONTROL SYSTEMS

The collapse of Bearings Bank (1995) the debacle of Enron Corporation (2001), the closure of Global Trust Bank (2004), bankruptcy of Lehman Brothers (2008) and the 2007-08 global financial crisis, and infamous Letter of Undertaking fraud of Punjab National Bank (2017), the failure of IL&FS, DHFL in 2018 etc. point out at one issue. Control Systems should be in place to avoid corporate failures. The word "control" is closely associated with aspects like cultural behavior in work place, budgets related to functional aspects like marketing, finance etc, variances and audits.

People establish Organizations with defined objectives. The management and employees of the organization work to achieve the defined objectives of the organization. The organizations have to perform their businesses within the legal framework of the country and the rules and regulations set up by the organizational framework. Hence this organizational control, the set of processes of assigning, evaluating, and regulating resources on an ongoing basis to accomplish the organization's goals is part of organizational activity.

Block 1 *Introduction to Management Control Systems* deal with controlling aspects of the organizations. The scope of management control is not restricted to accounting control. Management control is broadly concerned with the attainment of goals and implementation of strategies. The block has 5 units.

Unit 1 *Fundamentals of Management Control Management* provides the basic concepts on the controlling aspects of the controls in an organization. The control systems are very vital to any organization. Absence of foolproof Management Control Systems (MCS) can lead to huge losses and even to corporate bankruptcy. This unit deals with the issues that are covered under management control. The concept of Management by Objectives and how it enables the managers to introduce the control systems in the organization are explained. Internal and external factors that influence the management controls are discussed in this unit.

Unit 2 *Design of Organization Structure and Control Systems*, explains the structure of an organization, and discusses the concept of responsibility structure within an organization. The unit describes the significance of designing a well-defined organizations structure is very important for effective implementation of the management control system. It also discusses how to ensure management control of international businesses and non-profit organizations. The unit ends with a discussion on the use of control systems for empowerment, innovation, and creativity.

Unit 3 is *Organizational Culture.* The culture of an organization makes it distinct from other organizations. The organizational culture influences the behavior of employees working for the organization and, to an extent, has an influence on people in society at large. Hence, understanding organizational culture gives an insight into the behavior of people in general. This unit deals with the conceptual definition of organizational culture, describe characteristics of organizational culture and classified “culture”. The unit also discusses how the organizational culture changes on continuous basis.

Unit 4 *Strategic Performance Control*, focuses on the relationship between strategy and control. The performance of the organization has to take place within framework of controls designed by the organization. Vision, mission, and strategy provide direction to the organization to grow and expand. They help in guiding the organization toward optimum resource utilization and in directing the management's efforts. The unit introduces the concept of the balanced scorecard framework.

Unit 5 *Business Ethics and Management Control*, talks about the concept of ethical behavior in organizations. Organizations attempt to ensure that their employees behave ethically, using control systems. The unit discusses the management controls used and the ethical issues arising in the different organizational functions. It ends with a discussion on the different ways of regulating ethical conduct.

Unit 1

Fundamentals of Management Control

Structure

"If you choose to not deal with an issue, then you give up your right of control over the issue and it will select the path of least resistance".

- Susan Del Gatto, Stress Strategist and Author

1.1 Introduction

In an organization, it is important to have controls either in the form of checks and balances. This ensures smooth flow of the operations and any ignorance will only make the business and organization suffer. Hence Management Controls are important to steer the organization in the right direction. It is in this context, the quote connects with the unit.

[1]On January 29, 2018, Punjab National Bank one of the largest public sector bank through its Mumbai branch complained to Police that some of its officials have issued eight fraud Letters of Undertaking (LoUs) amounting to Rs. 280 crore for Hong Kong-based banks.

On 14th February 2018, Punjab National Bank identified a massive fraud of Rs. 13, 400 + crore at some of its Mumbai branches done by its own officials. The PNB fraud came to limelight on 14-2-2018 after the bank complained to the CBI that its own officials violated rules and put out illegal guarantee documents

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[1] https://www.ndtv.com/india-news/pnb-scam-involving-nirav-modi-how-the-events-unfolded-1816057

to help celebrity jeweler Nirav Modi secure credit from banks abroad. On February 16, 2018: The bank again approaches the CBI giving details of more transactions. PNB detected 150 Letters of Undertaking (LoUs) which were fraudulently issued by its officials in connivance with Nirav Modi and the other accused in the case.

This is a classical example of failure of control mechanism expected to be at place in all large bank branches which are regularly audited by the regulators like Reserve Bank of India for all the foreign exchange transactions, external auditors who audit the referred bank branches at regular intervals. It was stated that this type of Letter of Undertakings are being issued in the referred branch since 2011, there was no indication of the fraud since 2011 till 2018.

This example illustrate that the absence of control systems or malfunctioning of management control systems can lead to huge losses and even to corporate bankruptcy. Hence understanding the basics on management controls is very important learning for the student.

The scope of management control is not restricted to accounting control. Management control is broadly concerned with the attainment of goals and implementation of strategies. For example, the Tata Group implemented the ‘Tata Business Excellence Model (TBEM)’ to improve its business processes. The TBEM was implemented to bring about a transformation in the organization to enable it to face the dynamic and competitive business environment. TBEM included core values like customer-driven excellence, focus on the future, organizational agility, and management by fact, managing for innovation, valuing employees and partners, and visionary leadership. In addition to the development of strategy, TBEM focused on ‘strategy deployment’ and the attainment of ‘business performance/results’; both financial and non-financial measures were taken to assess business performance. TBEM promoted organizational excellence by:

- Increasing value consistently to customers which helped it gain corporate success,
- Improving organizational efficiency, and
- Creating an environment for sharing organizational information focusing on organizational learning.

In this unit, we shall introduce you to the fundamental concepts in management control. Management control systems are very vital to any organization. Absence of foolproof Management Control Systems (MCS) can lead to huge losses and even to corporate bankruptcy. Apart from accounting control, the scope of management control is broadly concerned with attainment of goals and implementation of strategies.

This unit will first explain the concept of control in the management context, and discuss the various approaches to management control systems. We shall then move on to discuss the different objectives of management control, and the schemes for classifying management controls. Finally, we shall discuss the contextual factors influencing management control.

1.2 Objectives

After studying this unit, you should be able to:

- Describe the issues that are covered under management control.
- Visualize how 'Management by Objectives' is a system of mutual controls within the organization, enabling managers to control their subordinates as well as each other. Also what could be its limitations?
- Analyze how the management control can be classified basing upon different parameters of control-object of control, extent of formalization of control and time of implementation of control.
- Discuss the contextual factors, both internal and external, that influence the management control.

1.3 Management Control – An Overview

An organization has to make an effective and efficient use of its resources to achieve its objectives and succeed in its operations. It should maintain an edge over its competitors in terms of cost and / or quality. Organizations can survive and continue operations in a complex business environment only if it meets its stakeholders' (customers, suppliers, employees, investors, the government, and society) demands. In this context, 'Management Control' needs to play its role.

The traditional concept of management control refers to the activities of establishing performance standards, comparing actual performance with these standards, and implementing remedial actions to achieve organizational objectives. This approach assumes that the performance standards are set for operations which will take place in an established environment. However, this assumption may not hold for organizations operating in a complex and volatile business scenario. In a complex and volatile business scenario, the most carefully crafted plans can go wrong. Hence, organizations need control systems which will help monitor and adapt to changes in the external environment, ensure best quality, cope with unforeseen change, and create faster cycles to market.

Anthony Ferner defines management control as a process whereby management and other groups are able to initiate and regulate the conduct of activities so that their results accord with the goals and expectations held by those groups. According to Joseph A. Maciariello and Calvin J. Kirby, a management control system is a set of inter-related communication structures that facilitates the processing of information for the purpose of assisting managers in coordinating the parts and attaining the purpose of an organization on a continuous basis.

A management control system may also be viewed as a collection of controls that are used to address one or all of the following situations:

- Managers and employees lack a clear idea of what is expected of them;
- They have a reasonable idea of what is expected but do not feel inspired, that is, organizational conditions (for example, reward system) fail to motivate; and
- In spite of knowing about the expectations and having sufficient motivation for performance, managers and / or employees are unable to perform.

A management control system assists the management in formulating strategies, coordinating the activities of the organization, and in steering the defined activities towards the achievement of the overall goals and objectives. Further, the controls should help the organization to maintain an edge over its competitors in terms of cost and/or quality. Organizations can survive and continue operations in a complex business environment only if it meets its stakeholders' (customers, suppliers, employees, investors, the government, and society) demands. Certain established performance measures are used to assess whether organizational activities are in sync with the goals and objectives.

Cybernetic Approach to Management Control

The term 'Cybernetics' is a trans-disciplinary approach for exploring regulatory systems, their structures, constraints, and possibilities. It was coined by Norbert Weiner in the 1940s, and has its origin in the Greek word 'Kybernetes'. According to Weiner, "cybernetics is the study of the entire field of control and communication theory, whether in the machine or the animal". Control systems in most organizations are based on the cybernetic approach – though they are customized to suit specific situations. When exercising the control function, a manager measures the performance of an individual, a plan, or a program against certain predetermined standards and takes corrective actions in case of deviations.

Basic control process

The basic control process involves the following steps –

- Determining areas to control
- Establishing standards
- Measuring performance
- Comparing actual performance against standards
- Rewarding good performance and/or taking corrective action when necessary
- Adjusting standards and measures when necessary.

Step 1: Determining Areas to Control

Before initiating the control process, the major areas that need to be controlled have to be determined. Such decision on control areas should be based on organizational goals and objectives defined during the planning process.

Exercising control over critical areas helps a manager manage a large number of subordinates effectively, reduce costs, and improve communication.

Step 2: Establishing Standards

Standards form the foundation for the cybernetic process. They are pre-determined benchmarks against which employee performance and related behavior is assessed. Standards may be incorporated into goals or may need to be developed during the control process. Standards are usually expressed numerically and aimed at achieving the desired quality and quantity within a specific cost and time boundary. For instance, the performance standard of a production worker could be to maintain a rejection rate of not more than 2 per cent (quality) or to ensure costs of producing a specified number of units are under a fixed amount (cost). As part of sales force control, the performance standard could be to meet a specific number of customers or prospects and to achieve a certain volume of sales during a given period of time.

In the context of employee behaviorur, establishing standards serves two purposes:

(i) It helps employees understand what is expected of them and how their work will be evaluated, thus helping them to perform effectively.

(ii) It also helps in identifying job difficulties related to the personal limitations of employees, which may include lack of experience, insufficient training, or any other task-related deficiency. Timely detection of such personal limitations makes it possible for the organization to take remedial measures before the deficiencies become serious.

The Management by Objectives (MBO) method encourages a participative approach to standard setting by involving employees in the setting of objectives.

Step 3: Measuring Performance

After establishing standards, a manager needs to determine how to measure the actual performance. Evaluation of actual performance becomes easy if performance standards are clearly established and the means for exactly determining what subordinates are doing are available. There are certain activities which are difficult to measure, and for which it is difficult to establish standards. As a result, most organizations use a combination of quantitative and qualitative performance measures.

After selecting the means of measurement, the frequency of measurement should be decided. Managers may need to control data on a periodic or continuous basis (as in the case of managers of air traffic control). Decision on the frequency of performance measurement depends on the importance of the goal, the nature of deviation from the standards, and the expenses that may be incurred on correcting the deviation.

Step 4: Comparing Actual Performance against Standards

The performance measured in Step 3 is compared with the standards established in Step 2. Managers often make comparisons based on the information provided in reports. Computerized information systems give supervisors direct access to real-time, unaltered data and information. Online systems identify real-time problems and situations that require a 'management-by-exception' approach. This approach suggests that managers should be informed about a difficult situation only when data shows a significant deviation from standards and when a situation is difficult for subordinates to handle.

Step 5: Rewarding Performance and / or Taking Corrective Action when Necessary

When an employee's performance meets or exceeds the standards, it should be acknowledged. Recognition of good performance helps sustain such performance and encourages further improvement. Specific actions should be taken to correct a negative discrepancy. The cause of deviation should be determined followed by the required action to eliminate or minimize it – which may involve redrawing plans. Managers may reassign or clarify the subordinates' duties and responsibilities. They may have to train existing employees; remove inefficient ones or recruit new employees. A manager should not only propose corrective action, he/she should also ensure that they are implemented correctly, for the successful rendition of the control process.

Step 6: Adjusting Standards and Measures when Necessary

The established standards may at times become obsolete and inappropriate and may need to be modified. To ensure that standards and performance measures meet future needs, managers should conduct a periodic review of standards. This review may entail changing organizational objectives, technology, improvement in the skill level of employees etc. If a manager feels that conforming to a particular standard may consume a lot of resources, it may be given low priority. The control process should ensure that it meets the current organizational needs. Management by Objectives (MBO) is a management control tool that can be viewed as a specific application of the cybernetic process.

Activity 1.1

Samhita is the marketing head of a publishing company. In using the cybernetic approach to management control, she determined the areas that she would have to control, as the first step. What are the rest of the steps that need to be undertaken to render the control process successful? What are the actions that she may take in a situation when a negative variation occurs between actual and planned performance?

Answer:

1.4 Management by Objectives

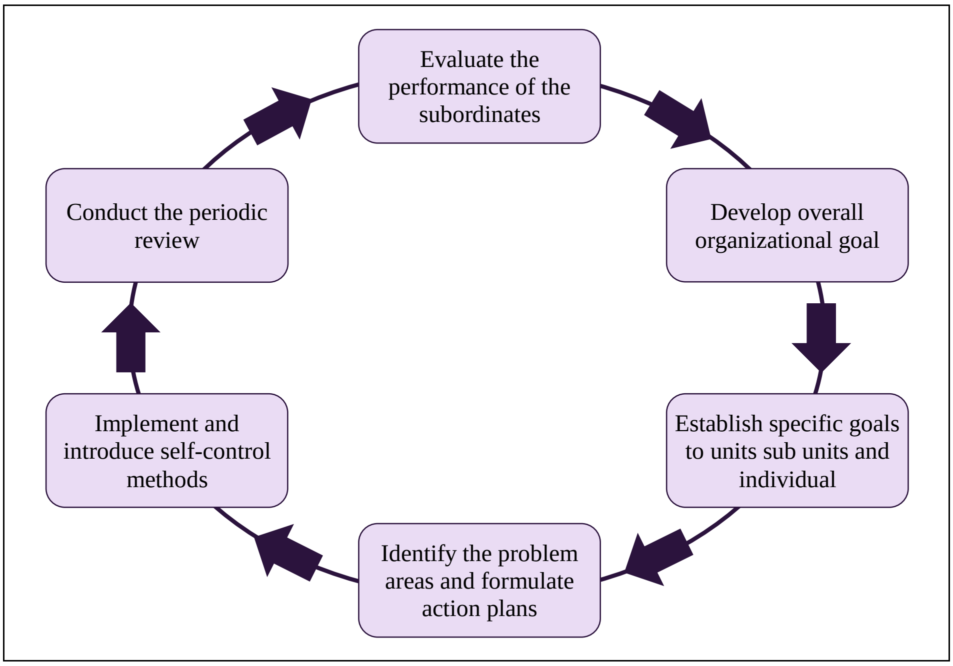
Management by Objectives (MBO) is a comprehensive management system based upon measurable and participative predetermined objectives. In terms of Peter F.Drucker, it is a system of promoting managerial self-control. Let us go into the details of MBO.

It is a management technique opted to increase the employee participation in the planning and controlling activities of an organization. Through participation, it is believed that the employee commitment towards planned course of action will be enhanced and their performance will tend to be more efficient.

Management by Objectives (MBO), proposed by Peter F. Drucker in 1954, aims at setting of goals / objectives jointly by the supervisor and the subordinate. This helps establish a system of mutual controls within the organization, which enables managers to control their subordinates as well as each other. The process also imposes self-control upon managers. Objectives set should be SMART (Specific, Measurable, Achievable, Realistic, and Time-Specific). MBO is similar to the control process used in budgetary control but at a much broader level.

The MBO process is explained in Figure 1.1.

Figure 1.1: Steps in MBO Process



Source: ICFAI Research Center

In the first step, managers must determine the mission and strategic goals of the organization. Goals must be set for all the key result areas of the organization. In the second stage, goals are set for various organizational levels so that each goal contributes to the achievement of the overall goals set for the organization.

Once the goals of various departments, subunits, and individuals have been set, action plans must be developed. Action plans state what is to be done in order to achieve a goal and how, when, where, and by whom. They should focus on the methods or activities necessary for achieving particular goals. Next, the subordinates should be given considerable freedom to carry out their activities and implement their plans. MBO is expected to help subordinates get a clear idea of what they should achieve. It gives direction to the subordinates and allows them to evaluate their own progress. Periodic reviews, then, ensure proper implementation of plans and achievement of objectives. They allow managers to measure results, identify and remove obstacles, solve problems, modify the action plans that are not achieving the expected results, and determine whether the plans and goals are apt for the organization or need to be modified. In the sixth step, performance appraisal is carried out. Performance appraisal focuses on the extent to which goals have been achieved, extent of shortfall in the achievement of goals, reasons for the shortfall, and preventive action required to avoid such difficulties in the future. It also recognizes the areas in which subordinates have performed effectively, and identifies areas in which individuals could improve by acquiring some specialized skills. The goals and plans for the next MBO cycle can also be discussed at this stage.

Rajasthan Spinning and Weaving Mills Ltd. (RSWM), a unit of the LNJ Bhilwara Group, is an example of an organization which has implemented the MBO concept. In RSWM, the top management decides on the organizational goals, while the departmental heads decide on the functional and individual goals in discussion with the employees. These functional and individual goals are then aligned with the organizational goals. After the objectives have been decided upon, the targets are set and revised as required.

1.4.1 MBO as a Management Control Tool

MBO facilitates the integration of individual, group, and organizational objectives. Its practice impacts various organizational processes and initiatives like performance appraisal, organization development, and long-range planning. As MBO forces the management to clearly state objectives, it leads to the development of effective controls. As it focuses on the result of activities, it helps in evaluation and control and in turn, in better management. A clear set of verifiable goals helps managers determine what should be measured and what action should be taken to correct deviations. MBO helps in identifying objectives for the key result areas; tries to link individual objectives with those of the organization; gives individual targets to all and thus, strengthens the employees' commitment to the organizational goals; and facilitates impartial performance appraisal thereby ensuring better performance.

1.4.2 Limitations of MBO

Some problems are inherent in the MBO process itself while others are due to shortcomings in the implementation of MBO concepts. Failure of the MBO process may occur due to:

- Failure among participants to understand the concepts of self-direction and self-control on which the MBO philosophy is built on
- Inadequacy of guidelines provided to those who are expected to set goals
- Failure to set verifiable goals against which performance can be measured
- Failure to revise individual goals as and when the organizational goals change
- Inadequacy of time and effort, too much of paperwork and inability to meet the high costs of managerial training
- Lack of top management's commitment which should be strong and sustained
- Misuse of objectives by overzealous managers - arising due to the over-emphasis on measurable objectives
- Frustration among managers arising out of dependence on one manager's efforts to achieve goals on the achievement of goals of others. Exhibit 1.1 depicts an example to it.

Exhibit 1.1: Management by Objectives in India

Very few organizations have applied MBO and a small number of them have shared their experiences with others. MBO came to India at first through the multinational companies operating in India. In the beginning, the overseas headquarters of previous subsidiaries provided skill. MBO has been adopted in private sector, public sector and government organization. Majority of the contemporary management organizations have followed the British model under which there is larger weight on corporate planning and control. MBO received a boost in India when it was acknowledged to be an integral part of "The HP Way", the highly praised management style of Hewlett-Packard. Managers had to develop goals and assimilate them with the other managers and the company as whole.

This has done at every level of management within HP. These written strategies are presented to the employees at all levels of the management so that they are clear as to what they are needed to do achieve these goals.

Later, the strategies were disseminated with others in the organization and co-ordinated. MBO has also been put into practice in many other organizations in India. Glaxo India Ltd., Bharat Bijlee, Blue Star, Grindlays Bank, Shaw Wallace, Hindustan Copper Ltd (HCL), Bharat Heavy Electricals Ltd (BHEL), Tamil Nadu Dairy Development Corporation, Department of Stationery and Printing, etc. are notable among these.

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The experience of these organizations reveals that the main reasons for failure of MBO are: lack of top management assurance and support, poor understanding of the true role of MBO and over-emphasis on evaluation.[2]

The HP Way: Performance Evaluation

In Hewlett-Packard, the performance evaluation method is implemented as a basic development device.

A common meeting used to be conducted every quarter by the management mixing people at different levels under one roof to evaluate management performance.

According to the HP Way the employees are given full freedom to place their requests and ideas in the meeting and their suggestions are strongly supported. The performance of the management can be approached in very informal way by the employees. The management gives the feedback to the employees on an ongoing basis. This reflects and made the company to introduce 360-degree and MOB appraisal method as measuring the company's performance.

Source: https://www.ukessays.com/essays/commerce/the-performance-management-at-hewlett-packard-commerce-essay.php published 23rd March, 2015

Another example of MBO.

Example: Management by Objectives

Groceries4u operated as an online groceries store. The marketing department had three goals for the year ahead – i) Improve the newsletter sign-ups by two times ii) Triple the social media followers iii) Increase the traffic to the company website by 40%. The marketing management team conducted individual goal-setting sessions wherein managers and team members discussed the marketing goals for the year ahead and the marketing efforts to be put in along with the individual goals to be achieved.

Sources: https://mooncamp.com/blog/mbo/, May 19, 2022 | Accessed on June 23, 2022

1.5 Objectives of Management Control

By integrating the organization’s diverse activities, the modern management control system addresses contextual issues that affect an organization’s short-term success and long-term survival. It detects environmental variables that can significantly affect organizations, ensures effective resource utilization, sustains competitive advantage, translates corporate goals into business unit objectives, maintains transparency and clarity of financial reporting, and preserves conformity with the relevant regulatory framework. It is also concerned with

[2] “Critical Analysis of Management by Objective in Indian Companies” The International Journal of Business & Management (ISSN 2321 – 8916) vol 2 issue 10 October 2014

operational efficiency issues. An adaptive MCS facilitates organizational learning and adoption of new strategies with a focus on the external environment variables, and making innovations that improve business processes and responsiveness to the market conditions. Towards this facilitation, it is important to set objectives of management control.

The Committee of Sponsoring Organizations of the Tread way Commission (COSO) broadly classifies the objectives of management control under the following heads –

i. Effectiveness and efficiency of business operations
ii. Reliability of financial reporting
iii. Compliance with applicable regulatory and legal framework

1.5.1 Effectiveness and Efficiency of Business Operations

An effective organization is one that is able to accomplish its purpose or mission, and is able to achieve the objectives and goals set within the scope of organizational purpose. Purpose reflects the intended position of the organization in society and the value that the organization aims to create for its target customers. An organizational unit is said to be effective when it is able to achieve the objectives and goals set within the purview of organizational purpose. An efficient organization will have achieved its purpose by utilizing minimum resources while meeting the expectations of its stakeholders. For example, Whistler Corporation, a large radar detector manufacturer in the US, witnessed a sudden spurt in the demand for its products. In order to cope with this demand, the production team took steps to increase production efficiency, compromising on quality assurance systems. This led to a rise in the defect rate from 4 per cent to 9 per cent and eventually to 25 per cent. This is an example of ineffective outcomes of an organizational unit. It should be noted that business operations refer to the whole array of organizational outcomes and not just production-related operations.

1.5.2 Reliability of Financial Reporting

Management control systems should ensure that financial statements are reliable and do not misrepresent facts or figures; should see that financial reporting has the qualitative characteristics of understandability, relevance, and materiality and also whether reporting has been done in conformity with applicable generally accepted accounting principles. Financial reporting refers to the preparation and publication of financial statements that may be done for interim periods or annually. These reports should provide a true and fair view of the transactions so that they may be referred to by both internal and external stakeholders evaluating the organization for their specific needs or ends. They may be a detailed or abridged representation of financial transactions which take place in the organization. Financial reports are used by investors, suppliers, customers, and creditors to make inter-firm comparison, to assess its viability in the long run while meeting its objectives in the short run. Management control systems should meet the disclosure requirements, to ensure that financial statements are reliable and do not misrepresent facts or figures.

1.5.3 Compliance with Applicable Regulatory and Legal Framework

The regulatory framework that includes legal and other compliance issues provides a boundary within which each organization has to function. Tax rates, pricing restrictions, workers' safety and welfare, and rules regarding international business are some of the important aspects for which the regulatory framework lays down standards of what should be done or not done. Organizations must at least fulfil these standards and aim at setting higher ethical standards for themselves. MCS should build in regulatory issues within its compliance objectives. For example, in the USA, infant formula manufacturers are required to provide the Food and Drug Administration (FDA) with a guarantee of the dietetic quality of their product before being able to commercially market it. The FDA has certain minimum requirements for labelling nutrient content, manufacturers' quality control procedures as well as company records and reports'. A company producing and marketing infant formula, in order to abide by the requirements of the regulatory body, would have to factor in these requirements within its compliance objectives, and in turn, into its new product development, production, and packaging processes.

The objectives should be prioritized and a cost-benefit analysis should be carried out before implementing control measures to balance objectives and available resources. A control system should provide reasonable assurance that there will be no sudden, unpleasant developments that could / should have been prevented by managerial action. While analysis of past occurrences may serve as a guide, a management control system should emphasize control of the present and the future. Controls may be used at specific stages of decision-making and execution activities through the organization structure, the organizational culture, and the organization's policies and code of ethics.

Example: Financial Reporting at Inditrade Capital Limited - Audited Consolidated Financial Results for the Quarter and Financial Year ended 31st March, 2022

The first page of the Annual Audited result shares that the report is also being declared as per Regulation 33(3)(d) of the Securities and Exchange Board of India (listing Obligations and Disclosure Requirements) Regulations, 2015 ('SEBI (LODR), 2015') and the SEBI Circular No. CIR/CFD/CMD/56/2016 dated May 27, 2016 the Statutory Auditors of the Company, Haribhakti a Co,

Contd….

LLP, Chartered Accountants, Chennai (Firm Regn. No: 103523W/W100048) has expressed an unmodified opinion in the Audit Report for the Quarter and Financial Year ended 31 " March, 2022.

This reporting also aligns with the compliance with Applicable Regulatory and Legal Framework and in this case, it is submitted to SEBI and the same is uploaded to the National Stock Exchange website too.

Investors, suppliers, customers, and creditors to make inter-firm comparison, to assess its viability in the long run while meeting its objectives in the short run, use financial reports. These statements are available for public / stakeholder access (Investors, Customers, Suppliers, etc.) on the website of Inditrade. As these statements are audited, the financial data presented there in stands out to be reliable. One of such financial reports is profit and loss account as shown below-

Inditrade Capital Limited
CIN : L67120KL1994PLC008265
Registered Office: Second Floor, M E S Building, Kaloor, Kochi, Ernakulam, Kerala - 682 017
Website:www.inditrade.com, Email:inditrade@inditrade.com, Ph:0484 6714800, Fax:0484 6714820
Statement of Standalone Financial Results for the year ended March 31, 2022
(All amounts are Indian Rupees in Lacs unless stated otherwise)

Particulars	For the quarter ended			For the year ended	
	31-03-2022 (Audited)	31-12-2021 (Unaudited)	31-03-2021 (Audited)	31-03-2022 (Audited)	31-03-2021 (Audited)
I. Revenue From Operations					
(i) Interest income	49.66	46.75	6.09	120.04	27.00
(ii) Net gain on fair value changes	5.80	-	0.10	5.80	0.10
(iii) Sale of services	119.44	120.40	26.89	301.33	120.30
Total revenue from operations (I)	**174.90**	**167.15**	**33.08**	**427.17**	**147.40**
II. Other Income					
(i) Other income	19.95	103.73	14.67	126.30	22.46
Total Other Income (II)	**19.95**	**103.73**	**14.67**	**126.30**	**22.46**
III. Total Income (I + II)	**194.85**	**270.88**	**47.75**	**553.47**	**169.86**
IV. Expenses					
(i) Finance cost	85.23	70.97	23.70	210.95	94.26
(ii) Employee benefit expenses	2.89	3.32	5.26	14.31	17.78
(iii) Depreciation & amortization expenses	73.14	73.16	2.57	151.47	7.89
(iv) Impairment on financial instruments	3.42	0.45	(3.45)	6.45	4.26
(v) Other expenses	14.13	10.79	12.68	259.60	30.44
Total Expenses (IV)	**178.81**	**158.69**	**40.76**	**642.78**	**154.63**
V. Profit/ (loss) before tax (III - IV)	**16.04**	**112.19**	**6.99**	**(89.31)**	**15.23**
VI. Tax expense					
Current tax	(0.27)	-	(0.04)	-	3.03
For earlier years	-	-	(9.98)	-	(9.98)
Deferred Tax	(18.70)	49.58	4.99	41.90	7.36
Minimum Alternate Tax	0.27	-	(3.03)	-	(3.03)
Total Tax Expense (VI)	**(18.70)**	**49.58**	**(8.06)**	**41.90**	**(2.62)**
VII. Profit/(loss) after tax (V - VI)	**34.74**	**62.62**	**15.05**	**(131.21)**	**17.85**
VIII. Other Comprehensive Income					
(A) (i) Items that will not be reclassified to profit or loss	-	-	-	-	-
(ii) Income tax relating to items that will not be reclassified to profit or loss	-	-	-	-	-
Subtotal (A)	-	-	-	-	-
(B) (i) Items that will be reclassified to profit or loss	-	-	-	-	-
(ii) Income tax relating to items that will be reclassified to profit or loss	-	-	-	-	-
Subtotal (B)	-	-	-	-	-
Total Other Comprehensive Income	-	-	-	-	-
IX. Total Comprehensive Income for the period (VII + VIII)	**34.74**	**62.62**	**15.05**	**(131.21)**	**17.85**
X. Paid up equity share capital (Face value Rs. 10 per share)	2,328.65	2,328.65	2,328.65	2,328.65	2,328.65
XI. Reserve excluding revaluation reserve as per balance sheet	-	-	-	6,727.99	6,781.99
XII. Earnings per equity share*					
Basic (Rs)	0.15	0.27	0.06	(0.56)	0.08
Diluted (Rs)	0.15	0.27	0.06	(0.56)	0.08

* EPS for the quarters are not annualised

Contd….

- The income a company generated from its regular, core business operations was known as revenue from operations, or operating revenue. For instance, ABC Automobile Co. built and sold cars every day as its primary business; hence, it was argued that all of its operational revenue was derived from the sale of cars.
- The beginning point for a profit and loss or income and expense account was revenue from operations.

Sources: i) https://reports.dionglobal.in/inditradeadmin/Reports/Financial%20Statements%20Q4%20FY2022_031331_848dc.pdf, May 2022| Date of Access – June 27, 2022

ii) https://www.accountingcapital.com/revenues/what-is-revenue-from-operations/, © Accountingcapital.com 2022 | Accessed on 30 June 2022

1.6 Schemes for Classifying Management Controls

The role of management is to plan, organize, integrate and interrelate organizational activities to achieve organizational objectives. This role is facilitated through different types of management control systems.

Management controls are classified based on -

- The object of control,
- The extent of formalization of control,
- The time of implementation of controls. (Refer Table 1.1)

Table 1.1: Management Controls – Classification Schemes

Classification Basis	Classifications
Object of control	Action controls • Behavioral restrictions • Pre-action appraisals • Action accountability • Results controls • Personnel / Cultural controls
Extent of formalization of control	• Formal control • Informal control
Time of implementation of controls	• Open loop control • Closed loop control • Feed forward control • Feedback control

Source: ICFAI Research Center

1.6.1 Based on Object of Control

Based on the object of control, management controls can be classified into action controls, results controls, and personnel / cultural controls.

Action Controls

Action controls are aimed directly at the actions that take place at different levels of an organization. They try to ensure that all actions, being taken by the personnel in an organization, are aimed at achieving the organization's objectives. They also ensure that all activities that are either non-beneficial or counter-productive to the attainment of objectives are avoided. Action controls may be implemented in the form of behavioral restrictions, pre-action appraisal, and action accountability.

Behavioral restrictions

One of the important aspects of action controls is behavior angle. The following are limitations in this perspective:

- These are limitations placed on the behaviorur of organizational personnel and are a form of negative discipline.
- An environment is created within an organization that deters one from doing things which are not in the organization's interests.
- The restrictions may be physical in nature (passwords on specific computers) or administrative (limited decision-making rights).

Pre-action appraisal

Here are some points covering what happens during pre-action stage. They are:

- It involves a supervisor reviewing a subordinate's plan of action.
- Control here takes place before an action is carried out so that wrong action may be prevented. For example, the Brand Manager may have to take the approval of the Vice President – Marketing before launching a new television commercial to replace an existing one.

Action accountability

Accountability is another aspect through which controlling will be taken up. The following are the details.

- This form of control entails making employees responsible for their actions and in essence is applicable after an action has been carried out.
- To be effective, it is required to set regulations for actions based on acceptability and unacceptability; make employees aware of this code; and have schemes in which commendable performance will be rewarded while non-conformance to regulations for action will lead to penalties. For example, a branch manager in a retail bank may be expected to follow certain norms while assessing the creditworthiness of a potential borrower. If the manager violates the norms and the borrower defaults on repayment, the manager will be liable to make the repayment to the bank.

Results Controls

Results controls are focused on the consequences of actions taken rather than on the actions themselves. These controls do not place any restriction on actions, and empower employees to use their discretion in doing what they feel is best for the organization. The outcome or output of action is the focus of control based on which a reward system is put in place. Individual rewards often accompany these controls to motivate individuals to perform well. For example, the branch manager in the previous example may be given a minimum target for new loan disbursements with a maximum limit set on the extent of defaults in repayment. And the branch manager may be rewarded only if he / she is able to exceed the disbursement targets while staying well within the specified extent of default. Here, the focus is on the outcome and not the action of whether the norms were adhered to while assessing the creditworthiness of the borrower. Results controls can be used at various levels of an organization, and are often used along with action controls. For example, sales personnel who are the point of contact with the customer are given the authority to use innovative ways to gain presence in the market and are paid on a commission basis depending on the units sold (result) during a given period. Similarly, sales personnel who violate the organization's code of conduct and adopt unethical means such as bribery may be severely penalized.

Personnel / Cultural Controls

Personnel / cultural controls aim at encouraging employees to monitor themselves and others with whom they work. These controls co-exist with action and results controls or are used in organizations to control aspects in which actions and results controls are not effective or sufficient. These controls are becoming more popular as organizations are changing their attitude of primarily focusing on maximizing profits by directing employees to function as per established rules and regulations. Many modern organizations believe that if employees have a sense of belonging and well-being, they will be automatically motivated to work in the best interests of their organization. This will be more effective in attaining organizational objectives than any formal rules, regulations, or penalties. Employees are, therefore, empowered to direct themselves and their peers within and outside their own groups.

These controls are established in a manner that certain culture, values, beliefs, and norms of behavior become intrinsic to the organization as a whole. It is to be ensured that the right people are placed in the right positions, and provided with the right resources. It is also to be ensured that the job is designed keeping in mind the person to whom it is being allotted. Training helps in orienting and familiarizing an employee with the organization's expectations. It also helps in new employees socializing with existing employees. Establishing a reward system which commends group achievement is suitable for personnel / cultural controls, rather than rewards based on individual performance. Establishing Group-reward systems enable the focus to shift to a group effort which motivates members of a group to monitor themselves and the others in the group.

In addition to above, financial controls also need some discussion hereunder.

Financial Controls

In this context, Financial Controls means 'Internal Financial Controls'. It covers financial reporting methods, strategic and operational methods opted by the business and how efficiently such methods are implemented.

In terms of *Explanation to section 134(5) of the Companies Act 2013,* Internal Financial Controls means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

The prime cadre responsible for effective implementation of these controls is: Board of Directors, Auditors, etc. The directors' responsibility statement and auditor's report are the examples which acknowledge how well the internal financial controls are carried out in an organization.

1.6.2 Based on Extent of Formalization of Control

Based on the extent of formalization, management controls can be classified into formal controls and informal controls.

Formal Controls

Formal controls or bureaucratic controls involve establishing standard rules and procedures for control of activities and their outcomes. These entail the delegation of tasks (authority and responsibility) in a structured manner within a well-defined framework; establishing a standard system for monitoring conformity with the rules and regulations; and formulating explicit systems of rewards, penalties, and approvals to ensure compliance. Policies, standard operating procedures (SOPs), budgetary controls, financial reporting, audit, performance measurement systems, and incentive systems are examples of formal controls.

Example: Business Code of Conduct at Coca-Cola

"Coca-cola business behavior served to guide our workers' activities in a way that was compatible with our Company values. Wherever we operated throughout the world, the Code of Conduct enabled our employees to act morally and in accordance with the law. The Coca-Cola Company updated its code of business conduct on February 12, 2018 put our established principles into action to fulfil our aim to succeed and satisfy the beverage customer.

Contd….

A crucial component of our company culture was abiding by the laws and regulations of the nations in which we conduct business and acting with respect, honesty, and integrity. The Coca-Cola Code of Ethics served was the foundation for all of our company policies, processes, and rules. The Board of Directors had approved it and given the go-ahead for its issuance and ongoing updating, which was required owing to changes in the business environment. The Coca-Cola Code of Ethics formalized our ethical values, harmonizes standards, and created a shared frame of reference that directed us to always behave in a thorough manner. It was a practical tool for the workplace that assists us in making decisions consistent with our principles, fostering success stories, and enhancing Coca-Cola's reputation", said José Antonio Fernandez Carbajal, Executive Chairman of the Board of Directors of Coca-Cola FEMSA.

Sources: i) Code of Ethics Coca-Cola FEMSA, https://coca-colafemsa.com/wp-content/uploads/2020/05/KOF-C%C3%B3digo-de-%C3%89tica-Ingl%C3%A9s.pdf, May 2020 | Date of Access – June 23, 2022

ii) Code of Business Conduct, https://www.coca-colacompany.com/policies-and-practices/code-of-business-conduct, 2022 | Date of Access – June 23, 2022 https://journal.eu-jr.eu/ttissh/article/download/1651/1576/, 31 March 2021 Date of Access – June 23, 2022

Informal Controls

Informal controls are not about any fixed rules and regulations. They are exerted by establishing a corporate culture and value system in which there is an interactive exchange of information which may not be strictly official at all times. For informal controls to develop and be effective, interpersonal relationships among employees at various levels are encouraged so that a feeling of trust pervades the organization and among external agencies dealing with the organization. Informal controls are found in organizations that rate high on innovation and creativity. Such controls may be nurtured through management training, office parties, etc., which encourage establishment of informal networks and contacts. They also help in making managers commit themselves to the values and beliefs of the organization for the achievement of organizational objectives. In a controlled organization, both informal and formal controls co-exist, and the effect of one is not independent of the other. Informal controls complement formal controls and in ways, dilute certain drawbacks of formal controls (for example, lack of trust due to a formal inspection which may be interpreted as prying and interference) by encouraging peer interaction, self-initiation, and creativity.

Organizations need both formal and informal control systems to operate simultaneously. For example, through informal interactions among managers of the parent organization and subsidiaries, organizations can ensure that formal controls like SOPs (Standard Operating Procedures) and budgets are being adhered to by the subsidiaries in reality. This information may not come out quickly in formal reporting of the subsidiaries to the parent organization.

1.6.3 Based on Time of Implementation of Controls

Based on the time of implementation of controls, management controls can be classified as open loop controls and closed loop controls. Open loop controls exist when an organization has a predetermined plan for attaining set objectives but there is no control mechanism to act if the actions deviate from the objectives. Open loop controls may be used when it is not feasible or economical to use a closed loop control mechanism.

A closed loop control mechanism involves monitoring of (expected) outcomes at regular intervals and taking corrective action if a deviation is expected to occur, or has actually occurred. Closed loop control mechanisms are further classified into feedback control and feed forward control.

Feedback Control

In the feedback control process, deviation from the plan occurs first and corrective actions are taken after the deviation is measured. Once the deviations are corrected, the plans are updated accordingly. The most important aspect in the feedback control process is the diagnosis of the reasons for such deviations and the development of strategies to avoid them in future.

Feed Forward Control

It entails continuously scrutinizing and monitoring the various processes in use along with the environment within which the organization is operating. Proactive modifications are made to either the processes or the environment or both, as and when the need arises. It has to function constantly from the start of the activity, and can stop only when the activity stops.

The major difference between feed forward control and feedback control is that feed forward control is an anticipatory control, where information flows in the forward direction, whereas feedback control is a follow-up control where information flows in a loop in the reverse direction. Organizations often use feed forward control in cash flow forecasting and management. In the planning and control context, feed forward control is very useful as it is future-oriented and prevents the occurrence of deviations.

Activity 1.2

Given below are some instances of management control. Name the class of control that is being exercised in each case.

a. An employee is allowed to access only one particular computer system. All other systems are password protected.

b. The advertising head of a media company should first seek the approval of the Vice President (Marketing) before launching a new ad campaign to replace an existing one.

c. A borrower defaulted on payment of monthly installments against a home loan for three consecutive months. It was found that the borrower had defaulted similarly in case of another bank loan and also had a bad credit card payment history. The loan officer had failed to gather these facts while evaluating the loan application. Now, the officer is liable to make the loan repayment.

d. A branch manager is given a minimum target for new loan disbursements with a maximum limit set on the extent of defaults in repayment. She may be rewarded only if she is able to exceed the disbursement targets while staying well within the specified extent of default.

Answer:

Check Your Progress – 1

1. A/An management control system facilitates organizational learning and the adoption of new strategies with the external environment in focus.
   a. Adaptive
   b. Boundary
   c. Diagnostic
   d. Traditional
   e. Feedback

2. All the following statements regarding financial reporting are true, except the one which says that.
   a. Financial reporting is a representation of financial transactions which take place in the organization.
   b. Financial statements bring out a 'true and fair' view of the transactions that have taken place in the organization.
   c. Financial reports are used only by internal stakeholders.
   d. Final reports are used by stakeholders.
   e. Financial reporting involves preparation and publication of financial statements which may be done on an interim or an annual basis.

3. Management controls may be classified into, based on the object of control.
   a. Formal controls and informal controls
   b. Feedforward control and feedback control

c. Open loop control and closed loop control
d. Action controls, results controls, and personnel/cultural controls
e. Adaptive control, diagnostic control and traditional control

4. Which of the following types of controls act as a motivating factor for individuals to perform well, in the hope of earning rewards?
   a. Action controls
   b. Results controls
   c. Personnel controls
   d. Informal controls
   e. Adaptive controls

5. What is a form of action control which entails making employees responsible for their actions and, in essence, it is applicable after an action has been carried out?
   a. Closed loop control
   b. Behavioral restriction
   c. Pre-action appraisal
   d. Action accountability
   e. Results control

1.7 Contextual Factors Influencing Management Control

Management Control Systems (MCS) provide both financial and non-financial information for management control and decision making. The design and use of control system is dependent upon the particular context of the environmental and organizational factors in which the controls operate.

The different factors (internal or external) which influence the effectiveness and operation of MCS include: the nature and purpose of the organization; organization structure and size; national culture; corporate strategy and organizational diversification; competitive strategy; managerial styles; organizational slack; stakeholder expectations and controls; and organizational life cycle, are discussed hereunder:

1.7.1 Nature and Purpose of the Organization

The nature and purpose of an organization (for profit or non-profit) chiefly determines the MCS design. A non-profit organization (NPO) is an organization in which owners do not earn any profit when revenues exceed expenses. It operates for the society's well-being and provides services, and does not participate in equity markets. It is funded by donor contributions and grants, and operating surpluses. The donors play a vital role in setting expectations for governance and management control, and the utilization of grants to achieve well-defined social objectives. Some ways in which NPOs differ from for-profit organizations are stated in Table 1.2. Controlling employees, systems, and processes is also different in an NPO from that of a profit-based organization.

Table 1.2: Non-Profit Organization vs. For-Profit Organization

Differentiating Factor	Non-Profit Organization	For-Profit Organization
Purpose	For the well-being of society	For pursuit of profits
Funding	Funded by donor contributions and grants, and operating surpluses	Equity, debentures, loans, and retained profits
Basis for calculating profitability	Amount of service that has helped in enhancing the quality of life in society through education, health, etc.	Financial profits
Use of profits	For the benefit of society	Passed on to the employees, the shareholders, and to the government as taxes
Type of rewards	Satisfaction derived from serving others.	Is in the form of monetary benefits – so, tangible in nature.

Source: ICFAI Research Center

1.7.2 Organization Structure and Size

Organization structure defines the formal configuration of job roles and responsibilities that individual employees or groups have to take up to carry out the organization's activities effectively and efficiently. It determines the organization's hierarchical structure that in turn, defines the reporting relationships between hierarchies. While designing control systems, characteristics of organization structure like centralization / decentralization and span of control should be considered.

A modern organization's structure should cope with a high degree of uncertainty, as new tasks are constantly added to the production or work process. An 'organic' organization structure adapts itself easily to unstable conditions in rapidly changing environments. As a business grows, the management's work increases and the organization structure becomes more complicated, making MCS for such organizations complex. Large organizations have more influence over the environment in which they operate. The use of mass production techniques in these organizations leads to mitigation of task uncertainty. In these organizations, the presence of many business units or functional departments leads to huge amount of information generation and processing. This makes it necessary to develop controls such as rules, documentation of the information, creation of specialized role functions, and a higher degree of decentralization.

1.7.3 National Culture

The MCS of any organization is influenced by the host country's national culture along with the objectives of the business units. It influences the way in which an employee interprets the information received from the business environment. Multinationals should be able to assimilate the cultures of different countries and create a common understanding among the employees. Geert Hofstede defined culture as "the collective programming of the mind that distinguishes the members of one category of people from those of another." He studied the values, beliefs, perceptions, and traditions of people in 50 countries and highlighted four dimensions on which culture varies across countries.

Each of the following dimensions affects the various aspects of management controls differently.

Power Distance

The distribution of power within the organization is an important feature. One of the important aspects under this are:

- Power Distance includes presence of hierarchical levels where there is inequality in the distribution of power.
- Organizations scoring high on power distance tend to follow strict budgetary control, a defined top-down approach of management, etc.
- Low score organizations follow a bottom-up approach of management and a more objective performance evaluation system.

Uncertainty Avoidance

This aspect covers risk dimension in the organization with respect to management controls:

- It refers to risk-taking ability and the extent of avoidance of ambiguity.
- Organizations scoring high have well-defined performance measurement systems explicitly connected to the incentive programs. Preference is given to a strict acceptance of rules.
- In low score organizations, culture is more open to flexible performance evaluation systems.

Individualism / Collectivism

These two features are prevalent in all the organizations. They have an influence on management control.

- It examines the tendency of people to either prefer working as individuals or as teams.
- In organizations high on individualism, people prefer to be appreciated for individual work, and prefer incentives based on individual performance rather than group performance.
- In organizations high on collectivism, people work as a team and believe in group rewards.

Masculinity / Femininity

The cultural features of masculinity and femininity play a crucial role impacting the management control as explained below.

- High on masculinity – a higher competitive spirit, independent thinking, assertiveness, etc. The higher the masculinity, the greater will be the tendency among employees to accept higher targets, and greater will be the tendency to expect incentives for individual achievements. In countries with low masculinity, the emphasis is more on better working conditions and team-based incentive programs.
- High on femininity – higher interdependence, inclination toward service, nurturing nature, etc.

The ease of designing and implementing control systems depends on the combinations of these dimensions. Each of these dimensions affects the various aspects of management controls differently. It is necessary for organizations to consider both the objectives of the business units and the culture of the host country when designing management control systems.

1.7.4 Corporate Strategy and Organizational Diversification

Controls at the corporate strategy level provide a strategic direction to the organization and also impact the degree to which its objectives can be achieved. To achieve goal congruence between the organizational goals and individual strategic business units, it is necessary that the MCS has a good fit with the corporate strategy. A well-made corporate strategy may fail unless it concentrates on fostering each business unit's success, individually.

Depending on the operating businesses, corporate entities can be classified into single business firms (deals with only one form of business) and diversified firms (deals with more than one business). Diversified firms are further classified into related and unrelated diversified firms. A related diversified firm has different businesses that are related in some way, share common core competencies. In these organizations, resources are shared between the different businesses, and there is open communication between the corporate managers and the individual business unit managers. When a firm has businesses operating in many different areas which are not linked, it is said to be unrelated diversification. These are however, financed and managed by a single parent firm.

Example: Corporate Strategy Meeting of Sony Group Corporation

On 31 March 2022, Sony Group Corporation’s Chairman, President, and CEO Kenichiro Yoshida conducted its strategy meeting. In the meeting, he discussed about the long-term corporate strategy of becoming a creative entertainment company by using technology and creativity as the strong foundation to realize the company’s purpose of filling the world with emotion (or kando) through the power of creativity and technology.

In order to deliver Kando to more number of users created in collaboration with creators, Sony strengthened its partnerships in the DTC (Direct-to-Consumer) services sector. This was done in an effort to increase the number of individuals who are now directly linked to the Sony Group—roughly 160 million—to 1 billion people who wish to consume entertainment.

In support of these initiatives, Jim Ryan, President and CEO of Sony Interactive Entertainment ("SIE"), said: "We are enthusiastic for the potential to continue to grow our community via investments in IP, group cooperation inside Sony, and investment in social and mobile." In order to continue driving the evolution and expansion of its company and to generate new value for creators and users from a long-term perspective, Sony intended to continue using the Group's numerous capabilities along the axis of its Purpose.

Source: Sony Corporate Strategy Meeting FY2021, https://www.sony.com/en/SonyInfo/News/Press/202105/20-042E/, May 26, 2021 Date of Access – June 23, 2022

Management controls differ depending on the type of diversification. Designing and implementing MCS for a diversified firm is more difficult than designing control systems for a single business firm. The greater the extent of diversification, the more the managers needs to update their expertise and knowledge about the firm’s operations. Firms that have opted for related diversification depend more on strategic controls while those that chose unrelated diversification depend more on financial controls to ensure performance. Strategic controls help in controlling the performance of individual businesses by evaluating all the operations in which the business is involved. Financial controls deal with setting certain standards for the level of financial returns expected and then comparing the achieved target with the standards.

1.7.5 Competitive Strategy

Michael Porter suggested three generic strategies which a business may pursue to gain competitive success – overall cost leadership, differentiation, and focus.

- If a business adopts the overall cost leadership strategy, it will cut costs in every activity of its performance, and MCS will be designed to achieve this efficiency objective.
- If it differentiates itself from the competitors through its products and services, it will incur extra costs to build in this differentiation, and MCS will work toward building value into the product that is more than the cost of value added.
- If the focus strategy is adopted, a small set of customers is targeted with an exclusive set of product offerings at premium prices, and MCS ensures the right pricing policy for the product offerings.

Exhibit 1.2 below describes the way Microsoft has differentiated itself from competitors.

Exhibit 1.2: Microsoft Corporation's Management Control System

Established in Redmond, Washington, Microsoft Corporation, is one of the largest multinational software corporation, having its existence from the year 1975. Many of the Microsoft products and services are being developed internally which turned out to give a highly competitive advantage to Microsoft Corporation because of its strong customer base. This internal development allows them to maintain a high competitive benefit through product differentiation and also have a closer technical control.

By applying, Michael E. Porter's five force strategy, we can understand the Microsoft's competitive position that are as follows:

- High rivalry among existing competitors like Apple, Google etc.
- The monopolistic nature of business caused strong entry barrier to l new entrants
- No substitute for technology products
- High bargaining power of customer, in terms of products provided by other software / hardware companies and
- As most of the suppliers are supported by Microsoft the bargaining power of suppliers is less.

Keeping quality as their 1st priority, the company's success factor is in

- The introduction and application of their products (software)
- Adopting differentiation strategy, and
- Leading in IT (Information Technology) industry.

Contd….

> The Microsoft Corporation's perspective has always been, to enable people and business throughout the world to realize their full potential. It has crossed over 200 thousand head counts of total employees including subsidiaries that are spread over 113 locations.

Source: Steven Lawrence, Management Control System of Microsoft Corporation, https:www.prezi.com, Nov 2013

1.7.6 Managerial Styles

Management style influences employees' behavior in an organization. The level of autonomy that a manager can sanction a subordinate depends on variables like the level of involvement of the manager in the subordinate's work activities and decisions, and the level of trust and confidence of the manager in the ability of the subordinate's influence. Managers differ in their managerial styles -- autocratic and democratic being the two common styles. An autocratic manager generally takes decisions on his / her own, which the subordinates have to follow. A democratic manager allows the subordinates to participate in the decision-making process.

Both autocratic and democratic managers can be permissive or directive. Some of the features of these styles are given below:

- An autocratic permissive manager will take the decisions on his / her own, but allow the subordinates to choose their own working style.
- An autocratic directive manager will take the decisions and also decide on how the work should be carried out by the subordinates.
- A democratic permissive manager allows subordinate participation in decision making and gives them freedom to decide their work pattern.
- A democratic directive manager allows subordinate participation in decision making but closely monitors the way in which the work is done.

1.7.7 Organizational Slack

Organizational slack is that capacity in an organization which is in surplus of what is required for normal operations. It may exist due to –

- Under-utilization of resources
- Setting targets lower than expected performance
- Giving a higher remuneration to employees than is necessary for retaining them
- Pricing products lower than is necessary for retaining customers.

When created as a part of budgeting activity, such surplus capacity is called budgetary slack, which is the amount that is budgeted in excess of the actual requirement. Creation of slack may be voluntary or involuntary. The effect of slack on an organization may be considered good as it provides for creativity, improvement and trials; helps retain people; accommodates any performance discrepancies; minimizes conflicts; and acts as backup in turbulent times and makes it easier for it to adapt to changes. Slack may also be considered 'bad' as it promotes managerial and operational inefficiency, which in turn hinders the attainment of organizational objectives.

Slack is an important consideration in designing MCS. In highly diversified firms, top-level managers have little knowledge of the intricacies of operations of individual units, which may lead to existence of slack. MCS in such organizations will then be required to include tight budgetary controls. In certain situations, control systems may be so designed as to tolerate slack – to prevent throttling of innovation and search for newer opportunities, and also to reduce information overload at the strategic management level. A higher slack in performance targets implies a lower probability of missing targets. Therefore, there are fewer requirements for investigation and in turn, less information to be processed by the top management.

1.7.8 Stakeholder Expectations

Stakeholders are individuals or groups of people who are impacted and who impact the organization’s activities and operations. Shareholders, employees, and management are internal stakeholders while customers, suppliers, creditors, the community, government, and other authorities comprise the external stakeholders. Organizations depend on these stakeholders in many ways. Investors provide capital, employees and management contribute their time and efforts toward the development of the organization, suppliers provide raw materials and services, customer loyalty leads to profits. The government, community, and other authorities give the organization the necessary rights and permissions to carry on a certain business. Likewise, the stakeholders too are dependent on the success of the organization’s strategies. To achieve the strategic objectives, the organization needs to have the right operational procedures and controls in place.

While designing its MCS, an organization has to consider stakeholders’ demands and the value it intends to deliver to them. This in turn leads to maintaining a mutually beneficial relationship that is profitable in the long run. Figure 1.2 shows the different factors to be considered and improved upon for increasing value for the specific stakeholders.

Figure 1.2: Responsibility of Organizations toward Stakeholders

Adapted from Business Ethics and Corporate Governance. ICMR Center for Management Research, 2004 and Walters, David. "Performance Planning and Control in Virtual Business Structures." Production Planning & Control. Vol. 16 Issue 2, March 2005, p226-239.

Exhibit 1.3 describes a research finding on the performance on financial, socio-economic, and environmental parameters by adopting a Triple Bottom Line approach.

Exhibit 1.3: Triple Bottom Line: Some Research Perspectives

John Elkington developed the concept of Triple Bottom Line (TBL) which had brought a paradigm shift in the way businesses, nonprofits and government's measure sustainability and the performance of projects or policies.

The TBL is an accounting framework that incorporates three dimensions of performance: social, environmental and financial.

The TBL includes environmental and social measures where as traditional framework does not consider these parameters however it is difficult to assign appropriate means of measurement for these two parameters.

The three dimensions TBL are "people, planet and profits". These are referred as 3Ps. Calculating the TBL is a challenge.

How do we compute these 3 Ps? Profits are measured in monetary terms. Measuring social capital and environmental health is a complex issue but the computational methodology and outcomes are different for all the three types of entities.

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One of the parameters to measure of an economy is GDP. For measuring TBL another indicator is used known as Genuine Progress Indicator (earlier known as The Index of Sustainable Economic Welfare -ISEW). Genuine Progress Indicator (GPI) is a measure that uses GDP as a foundation. It was first proposed in 1989 by Daly and Cobb in their book For the Common Good. A revised methodology was issued by a group called Redefining Progress in 1995 that changed the name of the measure to Genuine Progress Indicator (GPI). GPI computed using 25 variables covering economic, social and environmental factors. These variables are converted monetary terms (USD) and computed as a single monetary measure.

More than 20 states of USA are using GPI. Among the firms that have been exemplars of these approaches are General Electric, Unilever, Proctor and Gamble 3M and Cascade Engineering.10 Although these companies do not have an index-based TBL, one can see how they measure sustainability using the TBL concept. TBL measures the financial, social and environmental performance of the corporation over a period of time.

Source: http://www.ibrc.indiana.edu/ibr/2011/spring/article2.html The Triple Bottom Line: What Is It and How Does It Work? Timothy F. Slaper, Ph.D.Director of Economic Analysis, Indiana Business Research Center, Indiana University Kelley School of Business,Tanya J. HallEconomic Research Analyst, Indiana Business Research Center, Indiana University Kelley School of Business

In the first step, managers must determine the mission and strategic goals of the organization. Goals must be set for all the key result areas of the organization. In the second stage, goals are set for various organizational levels so that each goal contributes to the achievement of the overall goals set for the organization. Once the goals of various departments, subunits, and individuals have been set, action plans must be developed. Action plans state what is to be done in order to achieve a goal and how, when, where, and by whom. They should focus on the methods or activities necessary for achieving particular goals. Next, the subordinates should be given considerable freedom to carry out their activities and implement their plans. MBO is expected to help subordinates get a clear idea of what they should achieve. It gives direction to the subordinates and allows them to evaluate their own progress. Periodic reviews, then, ensure proper implementation of plans and achievement of objectives. They allow managers to measure results, identify and remove obstacles, solve problems, modify the action plans that are not achieving the expected results, and determine whether the plans and goals are apt for the organization or need to be modified. In the sixth step, performance appraisal is carried out. Performance appraisal focuses on the extent to which goals have been achieved, extent of shortfall in the achievement of goals, reasons for the shortfall, and preventive action required to avoid such difficulties in the future. It also recognizes the areas in which subordinates have performed effectively, and identifies areas in which individuals could improve by acquiring some specialized skills. The goals and plans for the next MBO cycle can also be discussed at this stage.

Rajasthan Spinning and Weaving Mills Ltd. (RSWM), a unit of the LNJ Bhilwara Group, is an example of an organization which has implemented the MBO concept. In RSWM, the top management decides on the organizational goals, while the departmental heads decide on the functional and individual goals in discussion with the employees. These functional and individual goals are then aligned with the organizational goals. After the objectives have been decided upon, the targets are set and revised as required.

Check Your Progress - 2

6. Which of the given statements about for-profit and non-profit organizations is incorrect?
   a. In for-profit organizations, the profits accrued are passed on to the employees, shareholders, and to the government, while in the case of non-profit organization, they are utilized for the benefit of society.
   b. In non-profit organizations, the rewards received are mostly intangible in nature while in the case of for-profit organizations, the rewards are primarily tangible.
   c. The profitability of non-profit organizations is calculated depending on how much the service has helped in improving the quality of life in society, while the profitability of for profit organizations is calculated in the form of financial profits.
   d. Both for-profit and non-profit organizations participate in the equity markets and so, shareholder expectations on 'return-on-equity' are relevant for both types of organizations.
   e. Non-profit organizations need not oblige any statutory compliance to the exchequer.
7. What has been defined as the collective programming of the mind that distinguishes the members of one category of people from those of another?
   a. Culture
   b. Strategy
   c. Structure
   d. Competitive strategy
   e. Education

8. As a dimension of culture according to Hofstede, what is uncertainty avoidance?
   a. Risk-taking ability and extent of avoidance of ambiguity
   b. Inequality in the distribution of power
   c. Tendency of employees to accept higher targets
   d. Defined top-down approach of management
   e. Encouragement of corporate culture
9. All the statements given here pertaining to the features of a culture that is high on the femininity dimension are true, except one. Identify.
   a. High interdependence
   b. Acceptance of higher targets
   c. Inclination toward service
   d. Nurturing nature
   e. Loyalty for organization
10. What depends more on strategic controls than the other? Identify both.
   a. Related diversified firms; unrelated diversified firms
   b. Unrelated diversified firms; related diversified firms
   c. Single business firms; strategic business units
   d. Strategic business units; single business firms
   e. Single business firms; unrelated diversified firms

1.8 Summary

- In the management context, 'Management Control' traditionally refers to the activities of establishing standards of performance, evaluating actual performance against these standards, and implementing corrective actions to accomplish organizational objectives.
- Management control is broadly concerned with the attainment of goals and implementation of strategies. In a dynamic environment, it helps fulfill the needs of effectiveness, efficiency, and adaptive learning.
- Management control is "a process whereby management and other groups are able to initiate and regulate the conduct of activities so that their results accord with the goals and expectations held by those groups."
- A management control system is "a set of interrelated communication structures that facilitates the processing of information for the purpose of assisting managers in coordinating the parts and attaining the purpose of an organization on a continuous basis."

- Management control systems are essential in situations where managers and employees do not have a clear idea of what is expected of them; where they have a fair idea of what is expected but do not feel motivated towards performance; or where, in spite of knowledge of expectations and sufficient motivation for performance, managers and / or employees fail to perform.
- The basic control process based on the cybernetic approach comprises the following steps: determining areas to control, establishing standards, measuring performance, comparing performance against standards, rewarding good performance and / or taking corrective action when necessary, and adjusting standards and measures when necessary.
- MBO, a concept propounded by Peter F. Drucker, is a specific application of the cybernetic process of management control. In this, goals / objectives (which should be SMART- Specific, Measurable, Achievable, Realistic, and Time-Specific) are set jointly by the supervisor and the subordinate.
- The MBO process consists of six steps: developing overall organizational objectives in key result areas; establishing specific goals for sub-units and individuals; formulating action plans while identifying possible problem areas; implementing self-direction and self-control among managers and subordinates; conducting a periodic review of plans; and appraising the performance of subordinates while allowing them sufficient autonomy to implement plans. Some of the limitations of MBO arise due to a lack of understanding of the philosophy of self-direction and self-control, the absence of adequate guidelines for performance, and the absence of verifiable goals against which performance may be measured.
- According to the COSO framework, objectives of management controls may be discussed under three heads – effectiveness and efficiency of business operations; reliability of financial reporting; and compliance with the applicable regulatory and legal framework.
- An effective organization is able to achieve its purpose and goals. The efficiency of an organization is its ability to achieve outcomes by utilizing the minimum resources. Financial reporting should have the characteristics of understandability, relevance, and materiality, and should be prepared in conformity with the generally accepted accounting principles. The compliance objective addresses regulatory issues (legal and other compliance requirements). Organizations should at least conform to regulatory standards of what should be done or not done and aim at setting higher ethical standards for themselves.
- Management controls have been classified based on the object of control (action controls, results controls, and personnel / cultural controls); the extent of formalization of control (formal controls and informal controls); and the

time of implementation of controls (open loop controls and closed loop controls). Closed loop control is further classified into feed forward control and feedback control.

- Action controls are aimed directly at the actions which take place at different levels of an organization. These can be further classified into behavioral restrictions, pre-action appraisal, and action accountability. Results controls focus on the consequences of actions taken rather than on the actions themselves. Personnel / cultural controls influence the people and the organizational culture, with the expectation that the right people in the right culture will perform the right actions that will ultimately yield the desired results.
- Contextual factors which influence the design and use of MCS include: the nature and purpose of the organization, organization structure and size, national culture, corporate strategy and organizational diversification, competitive strategy, managerial styles, organizational slack, stakeholder expectations and controls, and organizational life cycle.
- The nature and purpose of an organization, that is, whether it is a for-profit or a non-profit organization has a major impact on MCS. The aspects in which non-profit organizations differ from for-profit organizations include measurement of the profitability and utilization of profits.
- The organization structure establishes the formal pattern of job roles and responsibilities that individual employees and groups have to undertake, and the hierarchical structure and reporting relationships.
- An increase in size of organization necessitates development of controls such as rules, documentation of information, creation of specialized role functions, and a high degree of decentralization.
- The MCS of any organization is influenced by the national culture of the country in which it operates. Geert Hofstede identified four dimensions along which national cultures vary. The dimensions are: power distance; uncertainty avoidance; individualism / collectivism; and masculinity / femininity.
- To achieve goal congruence between the organization’s goals and those of individual strategic business units, it is necessary that the MCS has a good fit with the corporate strategy.
- Management controls also differ depending on the type of diversification -- related or unrelated. The choice of generic competitive strategy – overall cost leadership, differentiation, or focus - also influences the MCS.
- Managerial styles (autocratic or democratic, permissive or directive) play an important role in influencing the behavior of the employees in an organization, and thus, the design and implementation of control systems.

- Organizational slack refers to that capacity in an organization which is in surplus of what is required for normal operations. It may be created voluntarily or involuntarily, and may be considered good or bad for an organization.
- Stakeholders (investors, employees and managers, suppliers, customers, community, government, etc.) are defined as individuals or groups of people who are impacted by or who impact the activities and operations of the organization. It is necessary for organizations to consider what the stakeholders want while designing their MCS.

1.9 Glossary

Action Controls: This class of controls tries to ensure that all actions being taken by the personnel in an organization are aimed at achieving the organization's objectives. It attempts to ensure that all activities which are either non-beneficial or counter-productive to the attainment of objectives are avoided.

Cybernetics: Cybernetics is the study of the entire field of control and communication theory, whether in the machine or the animal.

Feedback Control: In the feedback control process, the deviation from the plan occurs first and corrective actions are taken after th**e** deviation is measured.

Feedforward Control: Feedforward control entails continuously scrutinizing and monitoring the various processes in us**e** along with the environment within which the organization is operating. Based on such scrutiny, proactive modifications are made to either the processes or the environment or both. This happens when the need arises for such modifications.

Formal Controls: Formal controls involve establishing standard rules and procedures for control of activities and their outcomes. These are also referred to as bureaucratic controls.

Individualism / Collectivism Dimension: The individualism / collectivism dimension examines the tendency of people to either prefer working as individuals or as teams.

Informal Controls: Informal controls are not about any fixed rules and regulations. They are exerted by establishing a corporate culture and value system in which there is an interactive exchange of information which may not be strictly official at all times.

Management by Objectives (MBO): MBO is setting of goals / objectives jointly by the supervisor and the subordinate. This helps establish a system of mutual controls within the organization, which enables managers to control their subordinates as well as each other. The process also imposes self-control upon managers.

Management Control System: Management control system is a set of interrelated communication structures that facilitates the processing of information for the purpose of assisting managers in coordinating the parts and attaining the purpose of an organization on a continuous basis.

Management Control: Management control has been defined as a process whereby management and other groups are able to initiate and regulate the conduct of activities so that their results accord with the goals and expectations held by those groups.

Masculinity / Femininity Dimension: Higher masculinity shows higher competitive spirit, independent thinking, assertiveness, etc., while higher femininity shows higher interdependence, nurturing nature, etc.

Personnel / Cultural Controls: Personnel / cultural controls influence the people and the organizational culture, with the expectation that the right people in the right culture will perform the right actions that will ultimately yield the desired results. These are one of the primary control alternatives.

Power Distance Dimension: Power distance includes the presence of hierarchical levels where there is inequality in the distribution of power.

Results Controls: Results controls are directly focused on the consequences of actions taken rather than on the actions themselves.

Stakeholders: Stakeholders are defined as individuals or groups of people who are impacted and who impact the activities and operations of the organization. Investors or shareholders, and employees / management form the internal stakeholders; while customers, suppliers / creditors, the community, the government, and other authorities comprise the external stakeholders of an organization.

Uncertainty Avoidance Dimension: Uncertainty avoidance refers to the risk-taking ability and the extent of avoidance of ambiguity.

1.10 Self-Assessment Test

1. "The traditional concept of 'management control' refers to the activities of establishing standards of performance, evaluating actual performance against these standards, and implementing corrective actions to accomplish organizational objectives." What basic assumption does this concept make? What is the management control and how is it better than the traditional concept of control? Enumerate the situations that can be addressed by management control.
2. "Management Control systems in most organizations are based on the cybernetic approach, though they are tailored to suit specific situations." Describe the basic control process according to this approach.

3. "Management by Objectives (MBO) aims at setting of goals / objectives jointly by the supervisor and the subordinate." Explain the steps involved in the MBO process. How does MBO facilitate management control? What are the limitations to this approach of management?
4. What are the objectives of management control systems as put forth by the Committee of Sponsoring Organizations of the Tread way Commission (COSO)? Explain each of these objectives.
5. "Management controls are classified based on the object of control, extent of formalization of control, and the time of implementation of controls." Elaborate.
6. "There are different factors which influence the effectiveness and operation of a management control system." Explain these factors in detail.
7. Write short notes on the following:
   a. Forms of action controls
   b. Feedback and feedforward control
   c. Hofstede's dimensions of national culture
   d. Organizational slack

1.11 Suggested Readings / Reference Materials

1. Stephen P Robbins, David A. De Cenzo and Mary Coulter. *Fundamentals of Management: Essential Concepts and Applications,* Fifteenth Edition| By Pearson Paperback – 30 June 2022.
2. Subhash Chandra Das, Management Control Systems – Principles and Practices, PHI Learning Pvt. Limited, Paperback – 15 July 2019.
3. Pravin Durai, Principles of Management: Text and Cases, First edition, Pearson India Education Services Pvt. Ltd.; Second edition (31 August 2019)
4. Xianzhi Zhang, Enterprise Management Control Systems in China, First edition, Springer-Verlag Berlin Heidelberg, 23 Sep 2016.
5. Prof. Kenneth Merchant and Prof. Wim Van der Stede, Management Control Systems: Performance Measurement, Evaluation and Incentives, Third edition, Prentice Hall, 2011.

1.12 Answers to Check Your Progress Questions

1. (a) Adaptive

An adaptive management control system facilitates organizational learning and the adoption of new strategies (where required) with the external environment in focus, and making innovations which leads to improved processes and better responsiveness to market conditions.

2. (c) **Financial reports are used only by internal stakeholders.**

Financial reporting refers to the preparation and publication of financial statements, which may be done for interim periods or annually. It may be a detailed or abridged representation of the financial transactions which take place in the organization. These statements should bring out a 'true and fair' view of the transactions so that they may be referred to by varied categories of stakeholders (internal and external) aiming at evaluating the organization for their specific needs or ends.

3. (d) **Action controls, results controls, and personnel / cultural controls**

Based on the object of control, management controls may be classified into action controls, results controls, and personnel / cultural controls. Based on the extent of formalization, management controls can be classified into formal controls and informal controls. Based on the time of implementation of controls, they can be classified into open loop controls and closed loop controls. Closed loop control mechanisms are further classified into feedback control and feed forward control.

4. (b) **Results controls**

Results controls empower individuals and groups to use their discretion in doing what they feel is best for the organization.

5. (d) **Action accountability**

Action accountability is a form of action control that entails making employees responsible for their actions and, in essence, it is applicable after an action has been carried out.

6. (d) **Both for profit and non-profit organizations participate in the equity markets and so, shareholder expectations on 'return-on-equity' are relevant for both types of organizations**.

A non-profit organization is defined as an organization that does not have owners who profit when revenues exceed expenses. Unlike a for profit organization, a non-profit organization operates for the well-being of society. In for profit organizations, the rewards received are mostly tangible and are in the form of monetary benefits whereas in the case of non-profit organizations, the rewards are primarily intangible, as for example, the satisfaction derived from serving others. A non-profit organization (unlike for profit organizations) does not participate in the equity markets and so, shareholder expectations on 'return-on-equity' are not relevant for such organizations.

7. (a) **Culture**

This is what Geert Hofstede defined the term ‘culture’. Geert Hofstede defined culture as the collective programming of the mind that distinguishes the members of one category of people from those of another. He studied the values, beliefs, perceptions, and traditions of people in various countries and on that basis highlighted four dimensions on which culture varies across countries - power distance, uncertainty avoidance, individualism / collectivism, and masculinity / femininity.

8. (a) Risk-taking ability and extent of avoidance of ambiguity

Uncertainty avoidance refers to risk-taking ability and the extent of avoidance of ambiguity. In a culture which scores high on uncertainty avoidance, organizations have well-defined performance measurement systems explicitly connected to the incentive programs.

9. (b) Acceptance of higher targets

Higher femininity implies higher interdependence, nurturing nature, inclination toward service, etc. In countries with low masculinity, the emphasis is more on better working conditions and team-based incentive programs. The higher the masculinity the greater will be the tendency for employees to accept higher targets and greater will be the tendency to expect incentives for individual achievements.

10. (a) Related diversified firms; unrelated diversified firms

Related diversified firms depend more on strategic controls while unrelated diversified firms depend more on financial controls to ensure performance. Strategic controls help in controlling the performance of individual businesses by evaluating all the operations in which the business is involved. Financial controls deal with setting certain standards for the level of financial returns expected and then comparing the achieved target with the standards.

Unit 2

Design of Organization Structure and Control Systems

Structure

"An organizational structure carries inherent capabilities as to what can be achieved within its frame."

- Pearl Zhu, Corporate Global Executive and Author

2.1 Introduction

An organization is made up of individuals and resources with varied capabilities & their placement at appropriate positions depending on their traits (behavioural and competency) directs the organization towards the vision.

The design of any control system is situational specific, in that it depends upon the type of managerial style used by senior managers and the corporate culture. Management control is exercised when people exercise their power or perform their duties based on the organization structure, abide by a code of conduct, or ensure adherence to policies and processes. This unit will explain the types of managerial styles, corporate culture and the design of control systems. Further, it will explain the structure of an organization, and discuss the concept of responsibility structure within an organization. We shall then move on to discuss the significance of designing an optimum management control system.

Subsequently, we shall discuss how to ensure management control of international businesses and non-profit organizations. Finally, we shall discuss the use of control systems for empowerment, innovation and creativity.

2.2 Objectives

After studying this unit, you should be able to

- Visualize the concept of managerial styles and how it differs from leadership styles.
- Describe what is corporate culture and the design of varied control systems.
- Discuss the meaning of Goal Congruence and the factors that influence it.
- Clarify what could be the formal control systems from the managerial perspective.
- Describe the different types upon which an organization can be built up and the important concepts that connects to it.
- Know how to ensure management control of international businesses and non-profit organizations.
- Recognize what should be the control system for empowerment, innovation and creativity. Diagnostic control systems, beliefs systems, boundary systems and interactive control systems can be well understood.

2.3 Managerial Styles and the Types of Managerial Styles

The main purpose of an organization is to achieve its goals and objectives. For objectives to be achieved, well-defined plans need to be implemented and executed. For successful execution of the plans, control is necessary at every stage and hence activities need to be verified for their compliance and also to ensure that the progress is made in tandem with defined objectives. This will help in correcting deviations.

Organizations comprise humans, their behavior and the need for control mechanisms directed towards congruent objectives. People interact with each other within the organization and that is termed as their behavior. It is evident in their choices, the things people do in organizations, the options and choices they make, and the way the organizations are led. Here the managerial style is expected to control and give direction to the actions of his subordinates.

Managerial Styles

It is not possible to have a uniform style for a manager when it comes to handling his subordinates. It is stated that every manager has his unique style in dealing with his subordinates and in deriving the desired output from them. He / she decides his course of action, based on the existing work culture in the organization. Further, changes can be made depending on the mindset of his / her subordinates towards their assigned work. Thus, the style that is adopted by a manager towards his subordinates is what is called as his ‘Management Style’.

Managerial Styles vs. Leadership Styles

Management Style and Leadership Style although applied interchangeably, do have some conceptual differences.

The difference between the two can be explained well through an illustration. If we compare an organization to the army, an army in peace time, is expected to function well when rules and procedures are clearly defined and different departments are well managed, in combination with good leadership at the top. On the other hand, an organization in war time, needs strong leadership at all levels, because people cannot be managed during war time, they have to be led.

The style to be adopted by a manager should be based on the management literature adopted by an organization. The reason being the focus in management literature is on control mechanisms and rationality in their approach. And a manager is expected to be a problem solver. A key word with regard to management is the complexity in operations, the procedures and guidelines. Hence, the style to be adopted should be on par with the successful accomplishment of objectives.

Thus, management controls people by guiding them in the right direction, but leadership motivates them by satisfying their human needs. The reporting hierarchy levels in an organization define the decision-making process. Managers predominantly focus on getting things done, whereas, leaders focus on the effects of the events and decisions for the people involved. However, there cannot be a clear distinction between the tasks of leaders and tasks of managers.

There is a difference between the concepts of management style and leadership style. Even though both the terms are used synonymously, they are different in their interpretation and approaches.

The difference between the management and leadership can be interpreted as under.

Different Management Styles

The managers have people who work for them. They follow different styles. Their behaviour comes into picture while they are adopting their styles. The following are the details.

Autocratic Style (Management Oriented)

This is one of the popular styles people adopt. Some of the features of this style are given below.

- The managers under this style of working do not give any hearing to the subordinates. The decision-making authorities, i.e. managers, leaders and superiors make their own decisions without giving any consideration for the ideas and suggestions provided by subordinates.
- There is no scope for employees to put forward their viewpoint.

- There are defined guidelines and policies formulated by their bosses. The subordinates need to follow them holistically. These guidelines and policies eventually become the company's policies.
- There is no motivation to employees.

Example: Autocratic Style of Mr. Donald Trump

Former US President Donald Trump was renowned for his authoritarian management style. Trump assumed ownership of his big firm and made all the important decisions. He even dismissed workers who weren't performing well while rewarding good performers with raises and other benefits, which appeared rigorous but just. This was successful for his business, but not so much while he was president of the USA.

Source: https://www.mygreatlearning.com/blog/autocratic-leadership/, Jan 30, 2022 | Accessed on 1 July 2022

Paternalistic Style (Leadership Oriented)

Manager acts as a patriarch or matriarch and treats employees / partners as the members of a large, extended family. Some of the features of this style are given below.

- Under this style of working, the leadership team decides for the betterment of the employees. The decision-making authorities, i.e. managers, leaders and superiors give due consideration for ideas and suggestions from subordinates.
- The employees benefit from the organization's policies.
- There is enough motivation to employees and creates a healthy and conducive atmosphere for work.

Democratic Style

The manager takes a more participative role in the decision-making process. Some of the features of this style are given below.

- Managers focus on their subordinates' feedbacks.
- The management and employees will be on the same table for discussion while discussing the plans, ideas and outcomes in terms of an organization's proposed objective.
- There exists a lot of communication process between them under this democratic style.

Laissez-Faire Style (Employee Oriented)

The manager follows a policy of non-interference:

- Under this style of working, superiors have very little to contribute to the organization. The decision-making authority is generally in the hands of the employees.
- There is lot of scope for employees to outshine, perform and grow.

Management by Walking Around (Team Oriented)

The manager follows a team approach. The other features of this style are given below:

- The managers feel they are mentors for their team.
- They interact with their subordinates and act as mentors as and when required.

Please refer Exhibit 2.1 for the management and leadership style of Jack Welsh, former CEO of GE.

Exhibit 2.1: Management and Leadership

The Leader at Microsoft: Satya Nadella

"Sometimes that means working with old rivals and sometimes it means forging surprising new partnerships." – Satya Nadella

"Hit Refresh" the book released by Satya Nadella in 2017 is a good look at Nadella's view of leadership. Here are the three things leaders have to do:

Bring clarity to those you work with. Simplify things.

Generate energy around your teams and the company. Build teams that are stronger today and tomorrow.

Find a way to deliver success. Balance short term and long term. Innovate. Be global minded.

Satya Nadella tried to change the culture of Microsoft from know-it-all to learn-it-all. The new culture at Microsoft is all about listening, learning more and talking less. In his book Hit Refresh he narrated his efforts to bring changing culture in Microsoft. Nadella's decision to launch Windows 10 in Kenya instead of Sydney was an effort to build a culture of inclusion. Both countries have educated and tech savvy customers as well as skill gaps. Building a culture that obsesses about the customer is not easy. Satya Nadella did that.

Satya Nadella, the CEO of Microsoft speaks of the strengths of his competitors with respect and acknowledges the need to find smart ways to partner with companies that have a strong market position with their service or device. Satya knows that he is leaving the audience shell-shocked when he pulls out an iPhone from his pocket. But this one has Microsoft software and applications on it. Being able to collaborate and compete with the giants in the marketplace means walking the tight rope. He has formed partnerships with his fiercest rivals – Apple, Google, Facebook, and Amazon – the AGFA companies.

Contd….

During October 2014, Satya Nadella in his participation at the annual Grace Hopper Conference (started in 1994 the Grace Hopper Celebration of Women in Computing is a series of conferences designed to bring the research and career interests of women in computing to the forefront) during the interview, to a question on pay parity to women, Satya Nadella answered that it was unnecessary to ask for the raise as the system took care of it and that women should embrace their superpowers and expect a raise from good karma. A person who turned out to be trustworthy and efficient in the long-term would definitely be given additional responsibility. Klawe, the interviewer disagreed and suggested that he should do some homework on what a reasonable salary was if offered a job and sit down with a trusted person and practice negotiating the salary he felt he deserved. Her view was applauded instantaneously. There were strong comments on Satya’s view. Later Nadella clarified that his answer to Marie Klawe’s question was completely wrong and he wholeheartedly supported programs at Microsoft and the industry that brought more women into technology and closed the pay gap.

In a gathering of 150 top executives of Microsoft Satya Nadella told these high-potential leaders that “once you become a vice president, a partner in this endeavor, a leader in this company, your job is to find the rose petals in a pile of shit, his idea was to remind his team that the job of a leader isn't to dwell on constraints, because there are always constraints. Instead, leaders are the "champions of overcoming constraints," keeping the team's eyes on the prize.

Source: (i) //blogs.timesofindia.indiatimes.com/just-like-that/book-review-hit-refresh-by-satya-nadella/ (ii) https://www.inc.com/business-insider/microsoft-ceo-satya-nadella-leadership-style-growth-mindset-hit-refresh.html this post originally appeared on Insider. Published On: SEP 27, 2017

2.4 Corporate Culture and the Design of Control Systems

It is the management style that has the strongest impact on Management Control Systems (MCS) in an organization.

Management style encompasses vision statement of the entity and the senior management, thereby inculcating control systems to achieve the same. The same can be achieved through either Centralized or Decentralized directions. The style of management also depends on entity structure. Hence, it is evident that the impact of management styles of top management and other hierarchical authority level has a significant influence on the design of management control systems. Also, researches have proved that top management characteristics significantly affect design and pattern of management control system of an organization.

Thus, the corporate culture and the design of control systems are influenced by the style of management the company follows. The management style in turn affects the control systems. The management is expected to understand interpersonal relationships and other related aspects to maintain balance for effective management and control.

2.4.1 Introduction to Corporate Culture and the Design of Control Systems

Organizational culture is considered to be one of the major factors that influence the MCS of an organization. Two organizations may have identical Management Control Systems, but their culture explains the reasons for variations in actual control. Organization culture is interpreted in the form of belief system, norms of behavior, value system, process flow, and procedures. The personality and policies of the senior management influences organization culture. The Management Control Systems establish a certain set of norms, values, procedures, and policies that are influenced by organization culture. Alternatively, the Management Control System influence the organization culture through defined process flows, policies and procedures.

It is evident that the management styles and organization culture significantly affect the design of MCS. Designing an MCS is a process of trial and error, and involves continuous adjustment. It evolves over a period of time, and as an organization grows, the MCS will have to grow along. It is considered as an incremental development.

The main question with regard to MCS is whether the information produced by the system is reliable and trustworthy enough and whether the system helps decision making. The system needs to be checked and verified for the need for additional adjustments.

The management style of the organization will mostly be developed by the management board along with direction for practical implementation of the elements. Eventually, the controller's department will work out the details and the framework. They use their professional judgment and fill in the gaps. They also look at how the organization is set up, and customize accordingly. The controller should be independent from any influences and help maintain an optimal shape of control. For an organization, it is important to have a management team that takes decisions based on the Decision Support Systems (DSS).

2.4.2 Management Control Systems

Management Control System is defined as a set of inter-related communication structures that facilitate processing of information and compiles information for management reporting purposes.

What is a Control System?

Controlling will be implemented through many ways. Some of the features are provided hereunder:

- It is designed to bring unity out of the diverse activities of an organization to fulfill an organization's purpose.
- It is an exercise of checking and correcting the organizational functions for the attainment of its objectives.
- It serves as a guide to attain the goals of the organization.

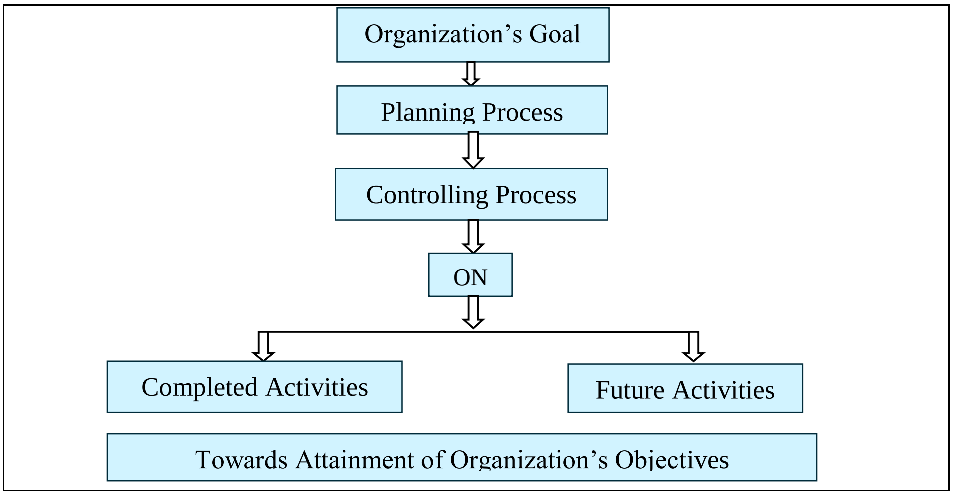
- It is a process of comparison and verification of the varied activities of an organization to examine whether the activities carried on are towards attainment of the organization's objectives or not. In case there exist any deviations, then the measures to be taken for correction are to be determined.

According to Phillip Kotler, Control Process is defined as "the process of taking steps to bring actual results and desired results closer together." According to Massie, Control is "a process that measures the current performance and guides it towards some predetermined goals." According to EFL Breach, Control is "a process of checking actual performance against the agreed standards or plans, with a view to ensuring the adequate progress and satisfactory performance."

Characteristics of a Control System are:

- It is a managerial function applicable at every level.
- It is a continuous process as long as the organization is a going concern.
- It tends to change with the change in the organization scenario.
- It is an action-oriented process because it tends to correct the process whenever it deviates from its determined goal.
- The prerequisite for control is planning as without planning, control process cannot be carried out.
- It is a mechanism to check, examine and regulate the actions and behavior of employees.
- It covers almost every aspect of an organization like quantity, quality, time, cost, etc. Thus, its scope of control is wide.
- It is a synonym for 'forward looking' because it aims for the attainment of future objectives of an organization.
- It is a synonym for 'backward looking' because it also concerns itself with the completed activities of an organization.
- It aims to attain the desired objectives of an organization.

Figure 2.1: Process to Achieve Objectives



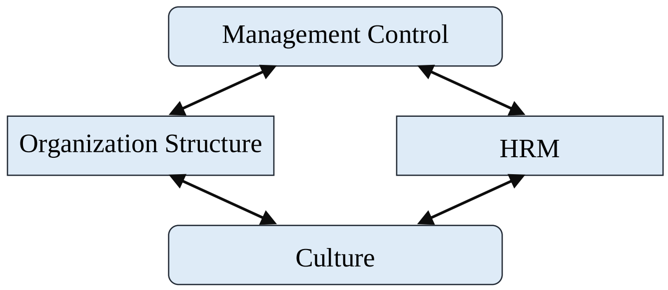
Source: ICFAI Research Center

Management Control

It is a control mechanism under which the managers influence other members of the organization to implement the organization strategies like:

- Planning (what the organization should do).
- Coordinating (the act of several parts of organization).
- Communicating information.
- Evaluating information.
- Deciding, if any action should be taken.
- Influencing people to change their behavior.

Figure 2.2: Management Control Process



Source: ICFAI Research Center

Please refer to Exhibit 2.2 for Ford's turnaround to cultural fuelling and diversity in workplace.

Exhibit 2.2: Ford's Turnaround to Cultural Fuelling and Diversity in Workplace

Ford Motors have an incredibly strong culture of diversity and inclusiveness that was stated to be a source of pride to the Company's Product Excellence, delivered with passion and constant innovation. This developed the commitment to Go Further- the tag line, and to work together as one team. The significance of this culture is linked to the firm's mission and vision statements, and the nature of its business.

Ford's culture is defined in the company's One Ford Plan that emphasizes on 'One Team, One Plan and One Goal'. Implemented by the Ex-CEO and President of Ford Motors, Alan Mulally— credited by Forbes as one of the greatest turnaround artists in American business history, reshaping the culture of Ford, after the 2008 US crisis—This culture plan aimed at unifying the global business organization to achieve consistency and synergy.

Contd….

Following are the main characteristics of the company's One Ford Plan:

- F –Foster Functional and Technical Excellence
  - This characteristic of Ford culture encourages its employees to learn and improve, by resorting to company's training activities and contributing their ideas for organizational development.
- O – Own Working Together
  - Team work is ordered first in Ford's culture that entails employee participation and personal development. This facilitates combined individual knowledge and skill development among the organization's employees.
- R – Role Model Ford Values
  - This feature signifies the business and its values in the form of integrity and positive behavior among the workers.
- D – Deliver Results
  - This feature demands the employees be accountable for delivering high performance results and satisfy their customers, deal positively in business realities, set comprehensive plans, and make sound decisions using relevant facts and data.

Ford CEO Mulally viewed this new corporate culture set around the word 'honesty' from the "people" aspect, bringing in every individual at every level of Ford in its growth equation. Their diverse employee base has continually attracted a highly skilled and committed workforce, reflecting a broad spectrum in bringing fresh ideas, perspectives, experiences, and life responsibilities that foster a truly collaborative workforce across the organization.

Source: Adapted from Carmine Gallo, www. forbes.com, May 2014, and Harry Kraemer, "How Ford CEO Alan Mulally turned a broken company into industry's comeback kid," www.Qz.com, June 2015, http:// www. at.ford.com/en/homepage, Jan 2016.

2.4.3 Goal Congruence

The main purpose of management control system is goal congruence. The decisions of the managers should be consistent with the objectives of the organization.

The goals of the organization's individual members should be in tandem with the goals of the organization. The actions and activities of the individuals should be in accordance with the organizational objectives.

2.4.4 Informal Factors that Influence Goal Congruence

On knowing the purpose of goal congruence, now it is a discussion on the informal factors that influence the goal congruence:

- External factors
- Internal factors

External Factors

These are anticipated desirable behavior in the society as explained below.

Ethics at Work: These are policies, rules and procedures prevalent in the industry. They are anticipated behavior based on the ethical background which the organizations are expected to adhere to, and abide by, in true spirit.

Behavior / Attitude: These are expected behavior in the society and anticipated responses from individuals to situations, in the society.

Gratitude / Belongingness / Ownership / Loyalty: The belongingness and inclination of employees with the organization they work. The feeling of ownership and the aspects of loyalty.

Job Matching and Profile Attributes: The psychological bonding and attachment to a particular profile. The affiliation to anticipated attributes of a particular job.

Diligence in Performance: The performance parameters and prescribed acceptance levels in a job.

Industry Specific Behavior: The nature and type of industry influence the behavior pattern of a company.

Internal Factors

The following are the internal factors that influence goal congruence.

Set of Customs and Traditions: The culture in any organization is defined through a set of customs, morals, codes, and traditions; these are inherent value systems manifested in an organization.

Standard Beliefs and Shared Thought Processes: The standard shared beliefs that are manifested in an organization.

Inherently Shared Common Value System: The shared value system manifested in an organization.

Acceptable Behavior: Acceptable behavior patterns, activities and prescribed set of anticipated responses.

Management of Performance and Tolerance Levels

The management of performance assumptions and evaluations coupled with accepted tolerance levels.

The Organization's Style of Functioning: The style of functioning of an organization.

Attitude of Owners and Top Management: This defines the attitude of the organization.

Attitude of Senior Management: The approach and attitude of senior management.

Attitude of Subordinates: The approach and attitude of subordinates.

Activity 2.1

In order to overcome dysfunctional behaviour of the employees, every organization strives to integrate the employee's personal goals to that of the organizational goals. This normally comes, when the employees are motivated to reach reasonable targets of their job, whilst aligning that achievement with their personal goals. What is the technical term used to refer to this unification? State its advantages and explain the factors that influence a consensus between the organization and individual goals.

Answer:

2.4.5 Informal Organization

An informal organization is an organization wherein interpersonal relationships among management and employees gain importance in their work culture. The behavior aspects, interactions, relationships, attitudes, personal, and professional attributes of individuals and affiliations are its fundamental features.

It is an organization based on social structure comprising practical working style and culture in an organization. The quality and quantity of work outcomes are based upon social networks, communication systems of common interest, and emotional source of motivation.

Example: Nestle System and Organization Structure

Legal Bytes is a Law Firm which provides online legal education for the professionals. They recently hired fresh law graduates from a law school from Bengaluru.

Contd….

They hired 11 such associates. All these associates are placed under a mentor. Due to this, the newly hired law graduates have access to the rest of the legal and paralegal team members in the organization from whom they can take assistance / support in delivering their duties and responsibilities as given to them at the time of their association. Further, all the new law graduates join every day for lunch with the rest of the team members wherein the informal conversations help them to equip with the culture, practices, policies etc. of the organization. Further, being a new generation law graduates, they are also allowed to collaborate with the Technical team in developing new learning tools for the firm's targeted community.

Sources: i) https://study.com/academy/lesson/informal-organization-definition-structure-examples. html. Dated: Year 2022 (Accessed on 2 November 2022)

ii) https://www.vedantu.com/commerce/informal-organization. Dated: Year 2022 (Accessed on 2 November 2022)

Components of Information:

The following are the components of information that are visible in an informal organization:

- Hierarchy and Vertical / Horizontal and Cross functional Line Management.
- Perceptions and Responses.
- Channels of Communication.
- Information Systems.
- Relationships and Flow of Information.

2.4.6 Formal Control Systems

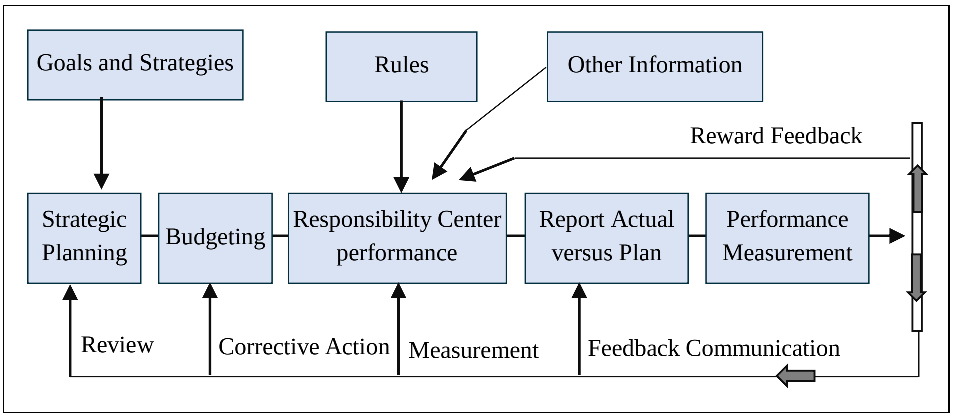
Management Control Systems comprise Formal and Informal Control Systems. Formal Control System includes goals and strategies, clear-cut rules, procedures, plans, guidelines, etc. that focuses on managerial aspects. The effective working of this system is very important because it has a direct impact on the managers and other employees towards attainment of organizational goals. The craft of the system should be to guide, motivate, direct and coordinate the employees for attaining the goals.

The rules under this system are of different types. They are in the form of

- Physical Control
- Manuals
- System Safeguard
- Task Control System

The following Figure 2.3 depicts one of the models of a formal management control system.

Figure 2.3: Formal Control Systems



Source: ICFAI Research Center

2.4.7 Functions of a Controller

The Controller is a person responsible for designing and operating the management control system. The Chief Financial Officer (CFO) is normally designated as a Controller.

The functions of a Controller are:

- Design and operate the financial information and control systems.
- Preparation of financial statements and its related reports.
- Preparation and analysis of performance reports, and interpretation of the same for decision- making.
- Supervision of internal audit and accounting control procedures.
- Development of management systems and related training process.

2.5 Organization Structure

For effective implementation of organizational goals, it is necessary to design the elements of control system infrastructure (such as organization structure, responsibility centers, rewards and performance measures) which are mutually supportive and adaptive. An organization structure should be designed in such a way that facilitates information processing and communication.

Organization structure refers to the role-responsibility relationships of individuals in an organization, along with their pre-defined interaction patterns. It specifies how individual employees should be teamed together to form sub-groups within the organization, and the formal techniques and methods of communication and coordination to be used in the organization. It facilitates the flow of information both vertically, that is, downward and upward communication between different hierarchical levels, and horizontally, that is, between different people at the same hierarchical level in the organization.

Example: Union Bank's New Organization Structure

The unified organizational structure of Union Bank of India had 125 regional offices and 18 zonal offices. This implementation came after Andhra Bank and Corporation Bank merged to form Union Bank of India on April 1, 2020. In order to improve its geographic penetration, the public sector bank opened four new zonal offices in Chandigarh, Jaipur, Mangaluru, and Visakhapatnam. The bank was able to significantly increase its market share in this crucial region thanks to the creation of two new zonal offices in South India. 32 new regional offices are also being established in various cities, including Shimla, Amritsar, Bareilly, and Mau.

On June 11, 2020, Rajkumar Rai G, MD and CEO, gave a statement to the media in which he stated: "With the growth in our footprint following amalgamation, a strategic reorganization was imperative to best leverage the opportunities ahead. With this in mind, we strengthened our pan-India presence to ensure an enhanced focus on business growth and customer service.

Source 1: Union Bank rolls out new organisation structure https://www.thehindubusinessline.com/money-and-banking/union-bank-rolls-out-new-organisation-structure/article31805195.ece, June 11, 2020 (Accessed on August 209, 2022)

From a management control perspective, the organization design selected should promote communication, cooperation, teamwork, motivation, and performance and should be the one best suited for the organization and its external and internal environment.

2.5.1 Structural Dimensions of Organization Design

Organizations in the past existed in a stable environment. 'Efficiency of performance' was the main consideration while choosing an organization structure. Today's environment, however, is dynamic and chaotic and requires the organization to survive amidst intense competition. Organizations need to be structured so that areas such as strategy, investments, marketing, internal processes, and human resources are managed and controlled in a manner that encourages communication, alliance and cooperation.

The dimensions entirely internal to the organization, which are used as a basis for formally describing the organization structure, are called 'structural dimensions'. The structural dimensions are shaped based on the 'contextual dimensions'. Contextual dimensions have a wider scope and include both internal and external factors like the organization size; the technology it uses; the environment in which it operates; the culture; and the objectives of the organization. According to Richard L. Daft, the different structural dimensions are – 'formalization, specialization, hierarchy of authority, centralization, professionalism, and personnel ratios'. Table 2.1 gives an overview of these six dimensions.

Table 2.1: Different Structural Dimensions

Dimension	Definition and Description
Degree of formalization	*Definition* Degree of formalization refers to the extent to which written rules and records are maintained in the organization. *Description* • It is maintained to document employees' activities and related behavior. • The number of pages of written records is one of the indicators of the degree of formalization. • MCS in formalized setup requires detailed reports to be prepared containing information about the activities and outcomes; periodic comparisons to be made and detailed variances measured to assess progress; and formal reward systems to be put in place to motivate contributions toward achievement of objectives. • In less formal organizations, the control mechanism is more implicit. • The degree of formalization can be high in jobs of routine nature, so that coordination is facilitated. • Professionals performing complex non-routine jobs may be de-motivated if they are bound by too many formal rules and procedures. • As organizations grow larger, one of the challenges as far as control system design is concerned, is how not to become too formal or bureaucratic.
Degree of specialization	*Definition* Degree of specialization refers to the extent of dividing the organizational activities into sub-groups, in which each employee performs only a small range of activities in which he / she is a specialist.

Contd….

	Description • The higher the number of sub-groups, the fewer the activities an employee performs and vice versa. • Also called as division of labour or functional specialization in which a job is broken down into several parts. It is useful in overcoming restrictions of time and knowledge in performing complex jobs. • In organizations with a high degree of specialization, the job performed by individual employees is of a routine nature. So, control systems usually consist of explicit rules and procedures which help establish certain standard actions and results.
Hierarchy of authority	*Definition* Hierarchy of authority refers to the reporting relationships prevalent in the organization and the span of control (number of subordinates who report to a supervisor). *Description* • The hierarchy of authority is flatter in organizations with a wider span of control, (where a large number of people report to a particular manager) than in organizations with a narrow span of control. • For effective control, the management needs to determine an optimal span of control of the organization depending on certain factors which include the complexity of the tasks performed by subordinates; the extent and nature of intervention required from the manager; whether tasks being performed by subordinates are identical or varied; and whether tasks being performed are interdependent or may be performed independently of each other.

Contd….

	• Tall structures provide closer supervision and tighter control by supervisors as there are only a few people reporting to a supervisor, while in flat organizations, supervision is less tight as a supervisor has a larger number of subordinates to supervise and the communication channel is simpler.
Degree of centralization	*Definition* Degree of centralization refers to the level in the hierarchy which has the decision- making authority. *Description* When the decision-making authority lies with the top management, the organization is said to have a high degree of centralization, and when the decision-making authority is distributed among the lower levels of the hierarchy, the organization is said to be decentralized. Decentralization gives the individual business managers the right to take decisions for their respective business units. • While a decentralized structure fosters innovation and entrepreneurship, and responsiveness to customer needs, centralization helps in strict adherence to plans. • Coordination at the lower levels of the organization may be lower in a centralized organization, resulting in loss of effectiveness, bottlenecks, and lack of responsiveness to market demands.
Degree of professionalism	*Definition* Degree of professionalism refers to the level of formal education of the employees. *Description* • The higher the number of years of formal education and training, the higher the professionalism.

Contd….

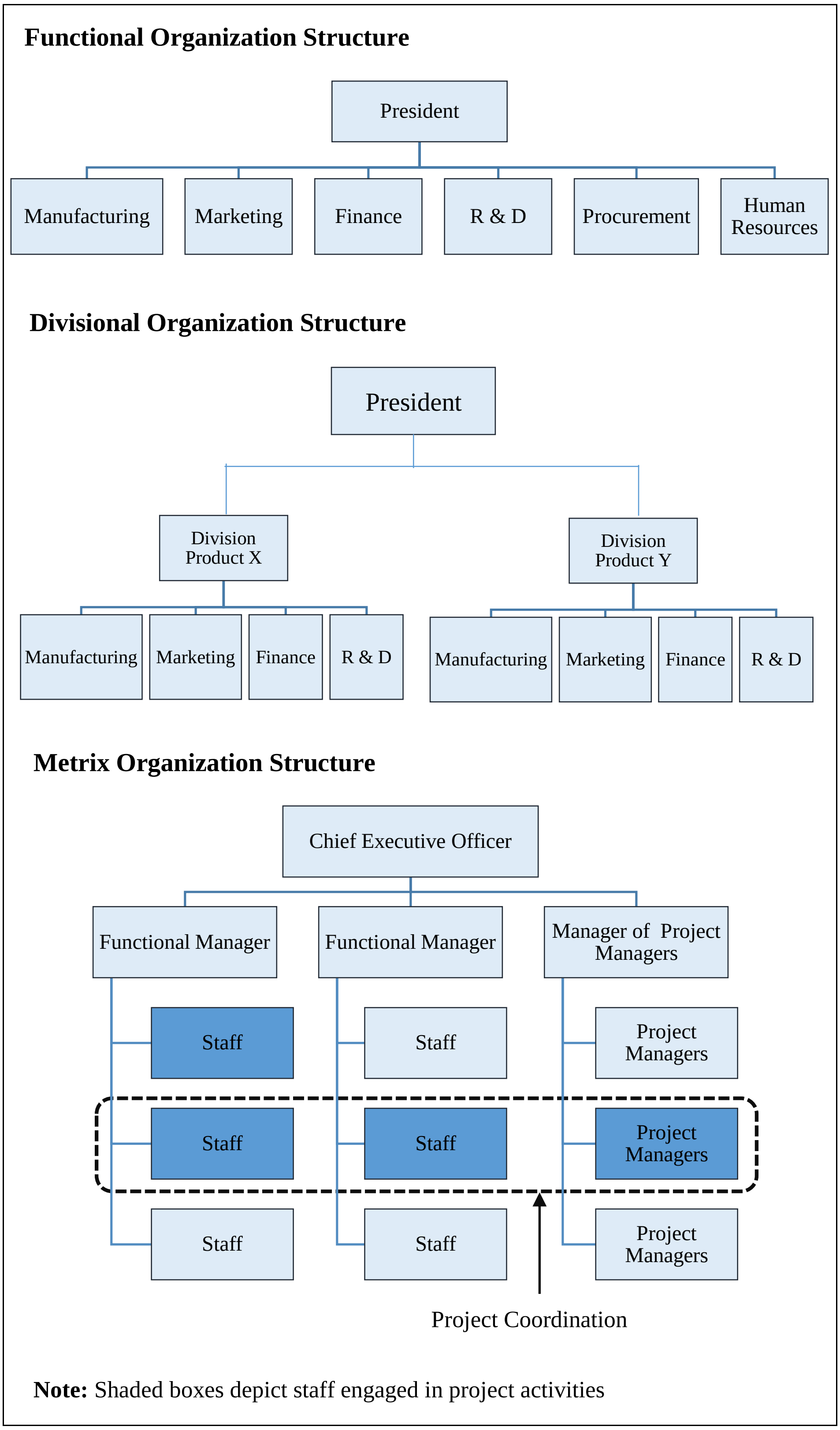
	• In organizations with a high level of professionalism, MCS may be designed in such a way as to provide an environment which encourages the accomplishment of objectives. • While professional individuals may not require very close supervision of actions and results, they need to be placed in the right jobs to feel sufficiently motivated. • Close supervision of actions and results is more useful where the level of professionalism is low.
Personnel ratios	*Definition* Personnel ratios refers to the distribution of people into different functions and departments. *Description* • In a specific function, it is calculated as the ratio of the number of people in the function to the total number of people in the organization. • They indicate the management's priorities and judgments regarding the deployment of people. • Examples of personnel ratios are administrative ratio, sales force ratio, etc.

Source: ICFAI Research Center

2.5.2 Types of Organization Structures

Organization structure decisions relate to the division of labor and the formation of departments. The divisions, or units; hierarchy, reporting relationships, and span of control of supervisors; and coordination mechanisms becomes part of the organization structure. The structure should encourage participation and innovation over and above the maximization of performance levels and effectiveness of operations throughout the organization. The various types of organization structures include — functional, divisional, matrix, horizontal, and hybrid structures. The advantages and disadvantages of these structures are given in Table 2.2. Figure 2.4 represents the various organization structures.

Figure 2.4: Model Organization Structures



Source: ICFAI Research Center

Table 2.2: Advantages and Limitations of Various Organization Structures

Organization Structure	Advantages and Limitations
Functional structure	*Advantages* • There is more emphasis on efficiency. • Employees are segregated based on their expertise and are able to specialize in the jobs assigned to their respective departments. *Limitations* • They face difficulty in adapting easily to environmental changes. • Most of the decision-making power is done at the top that leads to delay in the process.Lack of coordination between various departments and a myopic view prevailing among employees regarding organizational objectives lead to restrictions in innovation and creativity.
Divisional structure	*Advantages* • It is easy to measure the performance of each small unit and to reward commendable performance with more accuracy. • Increase in financial incentives and other rewards in the form of promotions, expressed praise, etc., can be directed at individuals and groups who actually deserve them. • Increased speed of communication, understanding, analysis, processing, and acclimatizing to new information (such as changes in customer preferences, supplier behavior, and change in risk profile due to the changed nature of competition). • Such information is first available to the individual divisions / units (closer to the source of the information) rather than the top-level management which is more concerned with broader issues affecting the organization as a whole.

Contd….

	Limitations • Negative impact of some decisions (made by a business unit manager who is responsible for the performance of only his / her division / unit) on other divisions. • A business unit manager may ignore the repercussion of, or may not have sufficient information required to assess the ripple effect of a decision made for his / her unit, on other units.
Matrix structure	*Advantages* ▪ Retention of the functional aspect helps retain economies of scale and that of the divisional aspects helps in incorporating customers' preferences, thus improving their own profitability. ▪ Economical sharing of resources among the various departments so as to achieve the organization's goals and objectives. ▪ Presence of dual authority leading to greater communication between managers. ▪ Capability of adapting to changes in the environment through better allocation of resources. *Limitations* ▪ Presence of dual authority leads to a higher chance of conflicts arising and so a lot of time is consumed in conflict resolution. ▪ Requirement of strong inter-personal skills in individuals within the structure. ▪ Meetings between participants take up a lot of time. Requirement of mutual respect among participants.
Horizontal structure	*Advantages* • Enables the organization to adapt easily to a changing environment, and it ensures that satisfaction and value addition for the customer are the main goals.

Contd….

	• Employee satisfaction due to shared responsibilities, enhanced authority for decision-making, and a clear understanding of an employer's contribution toward organizational goals. *Limitations* • More time taken to identify core processes; it becomes necessary to change the organizational culture, job structure and function, and performance measurement system; and there is the possibility that the employees' specialization in specific functions may be hampered. • Employees also require a great deal of training in varied areas in order to be effective in a horizontal structure.
Hybrid structure	*Advantages* • Scope for different ways of thinking and a participative style of management. • Aids quick decision-making, quick adaptability to market changes, increased spending on R&D. *Limitations* • Difficulty in identifying the environmental changes, deciding on the strategic modifications required for such changes, and the trickledown effect of such decisions.

Source: ICFAI Research Center

Activity 2.2
As no two companies are identical, businesses require structuring to survive. Without structuring, there will be no clarity or focus on running a business. It is due to this structuring process, we refer to businesses as 'organizations'. The more organized the business is, the more efficiently it will function in the long run. State briefly on how the organizations are classified, based on their structures. **Answer:**

Exhibit 2.3 depicts an example for it.

Exhibit 2.3: Winning Structure of Amazon Corporate Hierarchy

Amazon, started by Mr. Jeff Bezos in 1995, is one of the most customer-centric companies in the World. The company operates sites in all major countries at present; the company has about 566000 employees around the world working in the corporate offices, customer service centers, software development centers and the fulfilment centers.

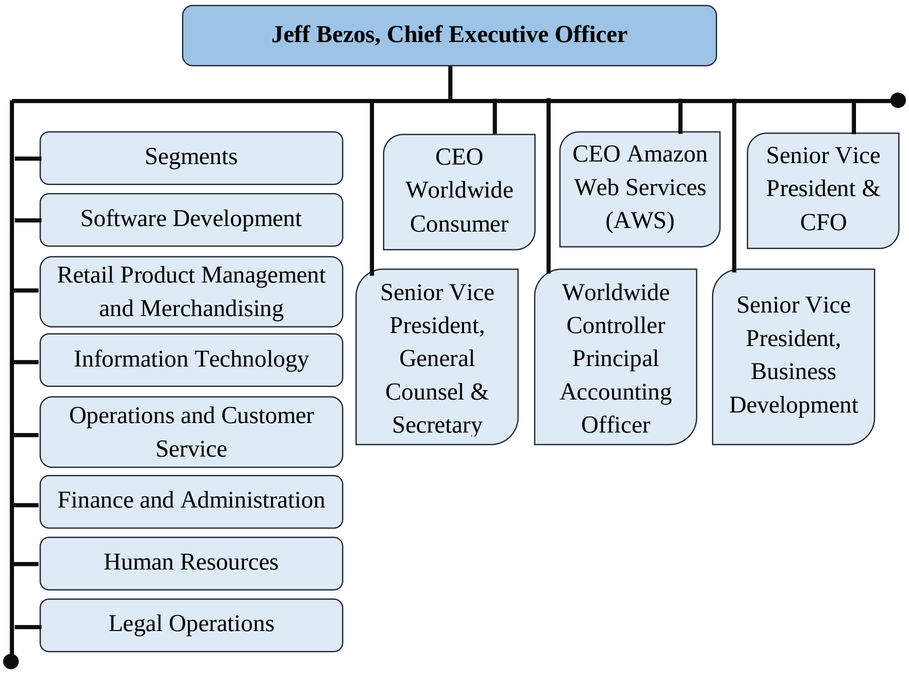
Amazon Products: Amazon Appstore Amazon Echo Amazon Kindle Amazon Prime Amazon Video ComiXology.

For the full year 2017, Amazon reported net sales increased 31% to $177.9 billion, compared with $136.0 billion in 2016, excluding the $210 million favourable impact from year-over-year changes in foreign exchange rates. Operating income was USD 4.1 billion, Net income was $3.0 billion, or $6.15 per diluted share, compared with net income of $2.4 billion, or $4.90 per diluted share, in 2016.

Number of employees was at 566,000 for the year ending 2017.

Subsidiaries of Amazon are A9.com, Alexa Internet, Amazon Books, Amazon Game Studios, Amazon Lab126; Amazon Publishing; Amazon Robotics; Amazon Studios; Amazon Web Services; Audible Inc.; Body Labs; Book Depository; Digital Photography Review; Goodreads; Graphiq; Internet Movie Database; Ring; Souq.com; Twitch.tv; Whole Foods; Market Woot; Zappos.

The organizational structure of Amazon at present (end of 2017) is as follows:



Source: https://www.amazon.com/p/feature/rzekmvyjojcp6uc

Check Your Progress - 1

1. What is a type of organization structure in which each manager is responsible for a specified function such as production or marketing?
   a. Functional structure
   b. Business unit structure
   c. Matrix structure
   d. Democratic structure
   e. Hybrid structure
2. In an organizational design, what refers to the number of subordinates who report to a supervisor?
   a. Centralization
   b. Personnel ratios
   c. Span of control
   d. Decentralization
   e. Quality center
3. Among the structural dimensions of organizational design, which of the following describes the reporting relationships prevalent in the organization and span of control?
   a. Formalization
   b. Hierarchy of authority
   c. Specialization
   d. Centralization
   e. Business process re-engineering
4. Which of the following organization structures is characterized by employees being grouped based on their expertise and skills?
   a. Divisional structure
   b. Functional structure
   c. Matrix structure
   d. Hybrid structure
   e. Business unit structure
5. As proposed by Frank Ostroff, the 'horizontal structure' is devoid of the rigidity and departmentalization that exists in a vertical system. Identify the organizations shift that is towards the horizontal structure.
   a. Delegation
   b. Centralization
   c. Integration
   d. Business process re-engineering
   e. Decentralization

2.6 Responsibility Structure

The responsibility structure represents the physical, human and financial resources that are entrusted to the project center manager. These resources represent the functional authority of the project center manager, and the resources in the custody of a manager influence his/her decision-making authority. Responsibility structure can be considered the second line of influence that the top management has over profit center managers.

A responsibility structure is a collection of responsibility centers. Each responsibility center is a function, division, or unit of an organization under a specified authority with a specified responsibility. Performance evaluation of each of these responsibility centers is done based on certain criteria (specific to each type of center) to assess its contribution to the organization as a whole. This evaluation is done using responsibility accounting. According to the Institute of Cost Accountants of India (previously Institute of Cost and Works Accountants of India), responsibility accounting is 'a system of management accounting' under which accountability is determined according to the responsibility allotted to various levels of management. The control system of the organization should be able to measure the influence that the activities of each manager have on the performance of the organization. In other words, it should be able to pinpoint the contribution of each manager to the achievement of the organization's goals.

Example: McDonald's Responsibility Structure

McDonald's Corporation, was one of the largest fast food chains in the world. The entire company was split up into distinct sections with duties determined by operational needs. McDonald's was present all over the world. Its activities were extensive and include Ronald McDonald and "drive thru" restaurants. The executives had the majority of the decision-making authority notwithstanding the finer branches and divisions. As a result, a worldwide hierarchy had been established, with headquarters receiving reports from lesser divisions. Every directive would be sent to middle managers, restaurant managers and other staff members from the parent company.

Source: Examples of Divisional Organizational Structure, https://harappa.education/harappa-diaries/examples-of-divisional-structure/, February 12, 2021 (Accessed on July 2, 2022)

2.6.1 Controllability, Goal Congruence and Transfer Pricing

While designing responsibility structures, organizations need to consider first two concepts — controllability and goal congruence. Transfer pricing is an important technique to measure the contribution of individual centers to the overall organizational goals, and to ensure that performance measurement systems are designed to be fair.

Controllability

According to this concept, each manager should be assessed and rewarded only for those factors that are under his / her control. For example, uncontrollable costs are those which the manager incurring the cost cannot influence over the relevant time period.

Goal Congruence

Goal congruence is achieved when managers (and employees), while working toward their best self-interest, as perceived by themselves, take decisions that are successful in attaining the overall goals of the organization. Performance measurement systems should be designed in such a way that the set objectives for the organization as a whole and the individual objectives of the manager (or employee) are properly aligned.

Transfer Pricing

"A transfer price is the internal price charged by a selling department, division, or subsidiary of a company for a raw material, component, or finished good or service which is supplied to a buying department, division, or subsidiary of the same company." In other words, transfer price is the monetary value assigned in responsibility accounting for exchanges that take place between the responsibility centers of an enterprise. This value is treated as the revenue of the selling center and the cost of the buying center. Therefore, it is essential that transfer pricing is correctly done in order to provide a fair picture of the contribution of different responsibility centers.

2.6.2 Responsibility Centers

Responsibility center, according to the Chartered Institute of Management Accountants, UK, is 'a segment of the organization where an individual manager is held responsible for the segment's performance'. It is a department, function, or unit of an organization headed by a manager who is directly answerable for its performance. Responsibility centers facilitate management control and help in implementing the strategies chosen to achieve the organization's goals. For a responsibility center, the accounting system generates information on the basis of managerial responsibility, allowing that information to be used directly in motivating and controlling the action of the manager in charge of the responsibility center. Every responsibility center uses inputs (material, labor, etc.) and needs working capital, equipment, and other assets to function effectively. While the costs of inputs can be easily measured, outputs are not always easy to measure.

The performance of a responsibility center can be judged using the effectiveness and efficiency criteria. Efficiency is the ratio of outputs and inputs. The lesser the input used to achieve a certain level of output or, the greater the output for a given level of input, the higher the efficiency of the organization. On the other hand, the effectiveness of the unit is decided on the basis of a unit's outputs and its goals. The greater the contribution of the outputs to the accomplishment of the organizational goals, the more effective is the unit.

According to the nature of monetary inputs and outputs, responsibility centers can be classified into four types. They are cost centers (which are further divided into standard cost centers and discretionary expense centers), revenue centers, profit centers, and investment centers. Each of the responsibility centers is described here.

Cost Centers

Cost centers are held responsible for the costs incurred but not for generating revenue. From the perspective of the cost center's manager, either the costs or the level of outputs can be independently controlled, but not both. A cost center can operate in two ways: either the cost budget is specified and the goal is to maximize the output, or the expected output is specified and the goal is to minimize the cost. In the first case, a certain fixed budget is allocated to the cost center, and it is expected to achieve the best possible result within the allocated budget. An example is the public relations department of an organization. In the second case, the goal is to achieve the required level of output at minimum cost; the performance level depends on the cost incurred by that center.

In the control of cost centers, managers often err by assessing performance with a view to only minimize costs. In doing so, they may ignore other important non-financial indicators of performance, as for example, the quality of the output, safety issues, or ethical and environmental issues. As there is no direct incentive to improve quality in the short-term, and the whole focus is either on cost reduction or on how to increase the output within a given cost budget, the quality of the output may be affected. For example, the manager of the manufacturing department may concentrate on the reduction of per unit costs by the use of long and continuous production runs. This may lead to increased inventory, and the organization might become less responsive to individual customer demands, which may lead to a reduction in sales. The control system in a cost center should therefore be designed in such a way that it recognizes the role of all factors that have an impact on organizational goals. The public relations, R&D, and maintenance departments of an organization are examples of cost centers.

Cost centers are of two types—standard cost centers and discretionary expense centers.

Standard cost center: This kind of a responsibility center is also referred to as an engineered expense center. This is usually found where a standard cost system is in place, usually in manufacturing organizations or in service organizations that have a repetitive task to be performed. The manager of such a responsibility center is responsible for both the direct costs incurred (such as direct material costs and direct labor costs) per unit of output, and the overhead expenses. Apart from the costs, the manager of the standard cost center is also responsible for the quality and quantity of the outputs. The objective of the manager in a standard cost center is to prevent or reduce unfavorable variance between the actual and budgeted costs, while maintaining the quality and quantity of outputs at the desired levels.

Discretionary expense center: For a discretionary expense center, it is difficult to measure the outputs in monetary terms against a given level of inputs. Generally, a budget is decided upon for the chosen time period, say, a financial year. Responsibility center managers are expected to maximize the services offered while keeping within the budgeted limits. Examples: corporate functions such as accounting, human resources and corporate communications; and departments involved in scientific research or new technologies.

Revenue Centers

Managers of revenue centers are held responsible for the revenues (outputs). Generally, these centers are not directly responsible for profits. Sometimes revenue centers are seen as incurring certain costs which are controllable to an extent, say, costs incurred in providing customized services to boost sales. Any costs, which are traceable to a revenue center are normally adjusted with the sales revenue to calculate the net revenue of the revenue center. If this is not done, there is minimal effort on the part of the manager of the revenue center to reduce them as these costs augment revenues and he / she is not entirely accountable for these costs.

In many organizations, the revenue centers are the closest points of contact with existing and potential customers. The main objective of revenue centers is to maximize net revenues. A company-owned sales outlet like the Tanishq Flagship Store is an example of a revenue center. Such a center is devoted to increasing the net revenue and assumes no responsibility for production. In this center, the outlet manager is responsible for the level of revenue or output measured in monetary terms, but is not responsible for the costs of the goods sold through the outlet.

Profit Centers

Profit centers are those responsibility centers which are responsible for profits. The manager of a profit center has control over both the input (cost of resources) as well as the output (revenue earned). However, a profit center manager does not have control over the level of investment, which may be controlled by the top management or which might have been pre-decided.

The objective of a profit center is to achieve profit targets: the manager of a profit center has to focus on both cost reduction and revenue maximization. The profit center manager cannot afford to reduce quality in order to reduce cost as that would lead to reduced sales revenue and profit. However, the profit center manager may not optimally utilize the capital employed as the emphasis is more on maximizing profit. For example, in order to increase sales for the current period, the profit center manager may allow sales on extended credit terms. This means that even though higher revenue is generated, it is not realized immediately. The capital, which may have been utilized for a more useful purpose, is blocked in the form of receivables to be realized at a later point in time. This blocking of capital amounts to a cost which is not attributed to the profit center. Even though the profit for the profit center is maximized, the resources of the organization as a whole are being wasted. In other words, there is local optimization, but not global optimization in terms of utilization of organizational resources.

There is a current trend to convert traditional cost centers into profit centers. For example, information systems / information technology departments earlier provided services to other departments (internal customers) free of cost. Now these services are being made chargeable in terms of a transfer price. In this scenario, the buying center also has the option of contracting with a firm outside the organization which can provide similar services. Likewise, the selling center (formerly a cost center) has the option of selling its services to other firms.

Investment Centers

Investment centers are held responsible for the overall economic performance in terms of the cost incurred, the revenue generated, as well as the associated investment. The performance of investment centers is measured with respect to Return on Investment (ROI) or Return on Capital Employed (ROCE) (which is arrived at by dividing profit by the capital employed in making that profit) and Economic Value Added (EVA). These concepts will be discussed in detail in the subsequent units.

In investment centers, the managers have control over the inputs, outputs and investments. This allows and motivates them to make the best possible utilization of resources under their control. However, the drawback of investment centers is that since the value of capital employed is taken from the balance sheet, the value of ROI or ROCE may depend on the accounting technique adopted by the organization. Moreover, the manager of an investment center may postpone new investments like purchasing new equipment or expanding capacity, as the ROCE will decrease in the short run, though the organization may benefit from these investments in the long run.

2.7 Designing Control Systems

Designing an optimal management control system is important for the effectiveness and long-term sustainability of an organization. A very low degree of control can result in confusion and chaos. On the other hand, too great a degree of control can result in eroding creativity and entrepreneurship. The effectiveness of a control system is evaluated by comparing the probability of achieving organizational objectives -where a control system does not exist with the increased probability or assurance of achievement when the control system is implemented. This increased assurance, which is referred to as the 'degree of certainty' derived from the system, is the benefit derived from the control system.

The 'degree of certainty' is described in terms of its 'control tightness' or 'control looseness'. Tighter control aims for a higher 'degree of certainty' and is often (but not always) accompanied by a higher cost of control. In designing management control systems, it must be seen that each of the controls used has a good 'fit' with others and that the controls are used in the right balance to promote efficacy and learning. It is essential that there exists a fit between the management control system and the internal environment. An MCS should also fit in with the organization's external environment to a considerable extent. Though prediction of the future is not an easy task, a well-designed MCS helps in preparing the organization for the future —especially to face changes in the environment.

Designing an MCS involves an understanding of the expectations from the organizational units and employees in terms of either the *key actions* (what activities the unit must perform in order to have the greatest possibility of success), or the *key results* (the outcome the unit must achieve for the organization to succeed), or both. It is also important to anticipate the *likely actions* and *results* in the absence of the control system. Problems may arise due to lack of knowledge of expectations of actions and / or results, lack of motivation to perform as expected, and lack of expertise to perform as expected. Depending on the degree of variance between the 'desired' and the 'likely', and the resources available to meet the costs of control, the management has to make decisions regarding the control alternatives which will constitute a control system and the extent of tightness or looseness with which they are to be implemented.

Control Alternatives

Action control, results control and personnel / cultural control are not mutually exclusive substitutes. Depending on the situation, various combinations of controls may be used in a management control system. The type of control that is required in an organization will depend on the purpose for which the management controls are being used. As a single type of control cannot usually address all problem areas in management, it is only appropriate that various types of control coexist in an organization.

The decision on the definite set of control alternatives to be used involves an analysis of the structural and contextual factors which influence control systems and also doing a cost-benefit analysis. Costs include the consumption of available resources, for example monetary costs relating to equipment, software, training, cash bonuses, and recognition mementoes. And the costs for implementing the system and maintaining it, for example payment to internal auditors, harmful behavioral side-effects like depletion of trust among managers and employees, and development of negative attitudes among employees. Benefits pertain to the extent to which the variance between desired actions and likely actions is minimized. It is not feasible for a control system to eliminate this variance altogether at a reasonable cost. An organization should be able to avoid sudden upheavals if this variance is minimized to the extent possible while keeping benefits derived higher than the costs incurred on designing and implementing the management control system.

After deciding on the set of control alternatives to be adopted, the organization's policies and practices should be framed and implemented to fit in such set of control alternatives. This has significant implications for the human resource management function in the organization. For example, employee selection criteria, performance appraisal practices and the design of reward systems may vary based on the selected set of control alternatives.

Personnel / cultural controls

Personnel / cultural controls are the primary control alternatives. They are implemented, by selecting the right people and placing them in the right jobs, by providing training and additional resources where ever required, by creating a culture which is intrinsic to the organization, and by designing group-based reward systems. On its successful implementation, it is possible to address most of the problems that come in the way of attaining organizational objectives. That is, the variance between the *desired* and the *likely* outcomes can be restricted by encouraging an environment where employees monitor themselves and their peers. This type of control incurs lower monetary costs and usually does not result in harmful side-effects or negative attitudes. Before considering other types of control, an organization must first assess the extent to which these controls may be used. Exhibit 2.4 describes the HRM policies and practices at Pixar, which emphasized personnel / cultural controls.

Exhibit 2.4: 2016-Disney is the Company Americans Want to Work for Most

Ranked at 53 in the Fortune 500 companies, Walt Disney was ranked number one by the Americans to work with in the year 2016. Disney was the most coveted employer for the year 2016.

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Interest in working for Disney may have something to do with how well the company performed on other portions of the same survey. According to the survey the respondents rated Disney the second-most trustworthy among the 100 companies. The respondents ranked Disney at fifth place for having the most positive global impact and at fourth place among companies that "care the most about you."

It was stated by the people who are working in Disney that the company provides a good job security. Working at "The Happiest Place on Earth "is the dream job at Disney. At Disney the two-word employee mission is "create happiness." Creating an environment where more than 60,000 workers strive to create happiness each and every day is nothing short of a difficult task for Walt

Disney World's HR staff. Their HR department focuses on the training to ensure the employees go beyond and prepare for the unexpected while in duty and always lead by example. According to Bloomberg BNA Disney's five-stage training process covers global orientation, line of business preparation, local orientation, on-the-job training and ongoing career management.

According to an [1]article published in https://www.shrm.org/ June 22nd 2014 "Appreciation is demonstrated in part by displaying pictures of employees being celebrated for the "quality principles" that Disney celebrates—safety, courtesy, efficiency and show (as in "ready for the stage"). Respect and equality are evident in that those on the payroll aren't "employees"; they're "cast members"—from custodial workers to stage performers. …….. Executives aren't inaccessible types who don't appreciate the challenges of the rank-and-file; pictures of Magic Kingdom executives are displayed prominently on tunnel walls with not just their titles but also their contact information."

Disney's business approach is to consistently over-manage certain things that most companies under-manage or ignore. Part of the philosophy at Disney is that "people remember people; Service quality is the total of the customers' perception of their experience."

Attention to Detail in Hiring: It starts with extraordinary attention to detail in the hiring and training processes, which ensures hiring people who fit Disney culture and consistently do what their roles ask of them. Disney works to hire the right people but also shapes them into employees who are comfortable in their roles and know their purpose. The HR department looks for those desirable traits in recruiting, but behaviors are coachable. Disney's philosophy is to match the mission of small teams with the culture of the whole organization.

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Jeff Williford, senior facilitator responsible for recruiting, hiring and training at the Disney Institute in Orlando during an interview[2] stated “So while there may be thousands of job classifications, there will always be one common goal: exceptional guest experiences, Training happens all year round at Disney with key repeatable messages to remind cast members to deliver consistent guest service that includes the entire experience”.

The Disney training process is a comprehensive strategy designed to promote and reinforce company values, history and operating philosophies. For Disney the training is more critical to ensure the desired behaviors and outcomes when compared to other companies. During the training, Disney focusses on core traits and makes all out efforts to communicate this to the employees through all modes of communication. Global orientation, line of business preparation, local orientation, on-the-job training and ongoing career management are the five stages of training process at Disney. The HR team at Disney believed that they carefully craft their message so cast members hear and understand that their actions continually enhance the legacy of Disney's heritage and traditions, by understanding where the Disney is. They're always in tune with the organization's culture and strategy.

Sources: i)http://fortune.com/2016/06/06/fortune-500-disney-most-desired-employer/

ii) https://www.shrm.org/resourcesandtools/hr-topics/employee-relations/pages/disney-employee-engagement.aspx

iii) https://www.bna.com/disneys-focus-employees-n17179890582/

Small, single business organizations find it easier to use tight personnel / cultural controls compared to large multi-business establishments, as in the former there is often a commonality between the desires of individual employees and that of the organization as a whole. Tight control is possible also in large organizations (for example, Google, Inc.), which essentially have a very strong culture (beliefs and norms which are strongly embedded) that acts as a guide. Tight control based only on personnel / cultural controls is not easy to achieve as these controls are easily affected by environmental changes. Lack of formal accountability for actions and their results may make employees too sure of themselves and may also result in a loss of direction and a decrease in effectiveness or efficiency. In order to achieve tightness of control, personnel / cultural controls are usually accompanied by actions and / or results controls, depending on the given setting.

Example: NTPC Mission

The mission statement of NTPC Limited is - "Provide Reliable Power and Related solutions in an economical, efficient and environment friendly manner, driven by innovation and agility".

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It means that NTPC is committed to the generation of reliable power at a competitive price through sustainable means through optimal use of variety of energy sources using innovative and eco-friendly technologies thus contributing to the society's upliftment and Indian economy at large. Thus the mission statement of NTPC implies standards of high work practices and community activism thus providing a direction for all members and employees actions, behaviour and quality control which forms the base for company's cultural controls.

Sources: i) https://www.ntpc.co.in/en/about-us/vision-and-mission, homepage (Accessed on 2 November 2022)

ii) https://www.ntpc.co.in/en/about-us, homepage (Accessed on 2 November 2022)

Action Controls

Action controls try to ensure that the activities themselves are in line with the objectives so that results need not be monitored. Tight action control is achieved when only those activities are allowed which are beneficial to the organization and detrimental activities are prevented. Established policies and procedures provide employees with a point of reference to do what is right and guide employees toward achieving what is expected of them. However, these controls also have their downside.

The various sub-classifications of action controls – behavioral restrictions, pre-action appraisal, and action accountability – have different implications for control system design. The costs to be incurred on establishing tight physical restrictions are high as for example, costs incurred on using top-end computerized security systems which will restrict access for unauthorized employees. Tight administrative behavioral restrictions can be implemented only if the personnel entrusted with decision making are capable of taking the right decisions and personnel who are restricted from specific actions are not able to violate such restrictions.

The time spent by the managerial staff for pre-action appraisal increases their workload. Such appraisals may not be necessary for all levels of employees and all kinds of actions. Discretionary use of this control enables avoidance of operating holdups, reduction in the size of managerial staff, or the productive use of time by the existing staff for activities that will generate revenue for the organization. Pre-action appraisal controls, in order to be tight, need to be thorough and should be carried out by competent personnel.

Controls in the form of action-accountability involve rewarding good actions and penalizing unacceptable ones. These controls result in a harmful side effect wherein employees lay more importance on the actions they perform rather than the results which are expected of them. For example, in a film-making agency, managers are allowed to spend on new technology, but a very stringent limit is exercised on them. If they spend beyond this limit, they are penalized. The managers concentrate on keeping within this limit and encourage their team members to work around some templates developed using existing technology. This policy restricts creativity among the filmmakers and prevents them from bringing in any innovative ideas.

Tight action-accountability controls require defining the desired actions; communicating the definition of the action to the performer of the action so that it is understood and agreed with; effectively tracking the action; and providing significant rewards or punishment for actions taken. The definition of the actions should specifically tell the performer what needs to be done instead of providing a general line of conduct which is indistinct. For instance, instead of saying “Distribution reach needs to be enhanced”, it may be specified as “Five sales outlets in rural areas and ten in urban areas have to be opened in the first two quarters of the next financial year”. Once the action has been defined, it is necessary to have an effective action-tracking system in place to achieve tight control. Rewards and punishments are an integral part of controls in the form of action accountability. They should be significant to the person being rewarded or punished. Rewards should provide significant motivation and the threat of punishment should act as a significant deterrent.

Results Controls

Results controls directly focus on the output of actions. In situations in which accepted norms for actions cannot be formed or are difficult to enforce, results controls are useful, but only if the outcome of actions can be assessed. These controls do not restrict creativity as they do not place limits on actions. They aim at ensuring that even new, innovative ideas and processes achieve desirable results. Employees are given the authority to use their discretion. This leads to greater dedication among employees toward their role in the organization. They can make mistakes as long as these mistakes provide valuable on-the-job training. Another advantage of implementing results controls is that the costs involved are less than in actions control. The information which needs to be generated for such controls very often already exists as it is also needed for strategic planning and financial reporting.

Results controls, in order to be tight, require setting of targets against which performance / output / outcome may be measured. These targets should be realistic and in congruence with the organizational goals. A well-designed reward-punishment (individual or group) system is required which rewards commendable performance and penalizes performance which has not met targets. These targets should ideally be set in consultation with the concerned employees. For example, at a call center handling customer complaints and services for an international bank, customer service representatives used to be evaluated based on the number of calls completed during a week. This target motivated employees to take more calls rather than concentrate on providing solutions to the customer grievances. This resulted in an increased number of repeat complaints and grievances. Later, the rewards were linked to the percentage of problems successfully resolved on the first call.

Costs of results controls include pecuniary costs relating to performance bonuses. It must be said here that results achieved are not always a function of employees' efforts. Results controls should take into consideration the fact that results may be affected by factors external to the organization and beyond the skill or motivation level of the employees. Targets and reward systems considered inappropriate by employees act as de-motivators and lead to negative attitudes. If results controls are to be successfully implemented, it is necessary to ensure that there is a correct understanding of the results. One major drawback of such controls is that they can be best used only in areas which are quantifiable. Employees develop a tendency to maximize only those aspects of their contribution which can be quantifiably measured and ignore the qualitative aspects. The result obtained therefore will not be optimal if too much importance is laid on results control. It should be accompanied by actions control and personnel / cultural control in order to have a management control system which provides a reasonable assurance of achievement of organizational goals.

Refer to Table 2.3 to understand the implications of various control alternatives on the human resource management policies, processes and practices.

Table 2.3: Control Alternatives and Their Implications for HRM – An Illustrative List

Control Alternative	Implications for Human Resource Management
Personnel / Cultural Control	• Recruitment, selection, and placement: Guidelines on qualification, experience, skills, attitudes, and behavioral traits • Orientation and socialization, especially for cultural values and ethical norms • Employee training: Job skills, soft skills • Management development: Career planning, succession planning • Trait / knowledge / skill-based appraisal of employee's potential • Compensation administration: Merit pay, skill-based pay

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	• Benefit schemes to foster belongingness and a sense of security • Organization development (OD) and change: Building new competencies, culture change, organization climate change • Quality of work life (QWL) • Employee involvement: Workers' participation in management • Employee relations to pre-empt conflicts • Voluntary retirement schemes to ensure personnel / cultural fit to changes in business environment and strategy
Action Control	• Hierarchy and reporting relationships • Clarity of roles, responsibilities, authorities, and distribution of power between key positions • Workflows and channels of communication (vertical and horizontal) • Behavior-based appraisal and reward systems • Disciplinary action: Absenteeism, violation of rules and regulations, fraud, etc. • Change management: Business process reengineering, organizational restructuring
Results Control	• Employee performance management: Goal-setting, performance appraisal, and feedback • Performance-based incentives (individual bonuses, team bonuses, commissions for sales force, employee ownership of company's equity shares) and disincentives for non-performance

Note: In the medium term, reward systems based on results (results control) help in attracting high performers (personnel control) and nurturing a performance culture (cultural control).

Source: ICFAI Research Center

2.8 Management Control of International Business

During the past few decades, one of the most dramatic changes that has taken place in business corporations has been the rapid internationalization of their operations. Changes have been brought about in the organization structure as a result of this strategy. In addition to changes in the organization structure, a number of additional control challenges have been created, some of which are related to the control structure, while others are related to the control process.

The complexities and uncertainties in the business environment make it necessary for the organization structure and management control system to be designed in such a way that the benefits earned from operating in numerous countries are higher than the costs incurred. Designing the organization structure of an MNC entails taking decisions on three main aspects – the strategy of international business; extent of centralization; and the division of an MNC into subsidiaries based on product, operational location, or function.

2.8.1 Strategy of International Business

According to Christopher Bartlett and Sumantra Ghoshal, organizations can choose from one of the four strategies for doing international business: international strategy, multi-domestic strategy, global strategy, or transnational strategy. These are described in Table 2.4.

Table 2.4: Strategy of International Business

Strategy	Description
International Strategy	• It involves transfer of know-how and / or products developed in the home country to foreign markets where they are scarce or unavailable. • It is used when there is not much of a pressure on cost reduction or local responsiveness.
Multi-Domestic Strategy	• It involves adapting to local requirements by customizing both product and marketing strategy. • There is usually a poor flow of know-how between the parent organization and the subsidiary. • It is used when the pressure on cost reduction is not high, but the focus on local responsiveness is significant.
Global Strategy	• There focus is on cost reduction by selecting locations for value addition based on the objective of minimizing costs and achieving economies of scale along with the beneficial effects of learning and experience.

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	• There is usually a one-way flow of know-how from the parent organization to the subsidiary. • It is used when there is a lot of pressure on cost reduction without significant pressure on local responsiveness.
Transnational Strategy	• It aims at achieving both cost reduction and local adaptability while encouraging a two-way flow of know-how between the parent organization and subsidiary. • It is used when there is a need for worldwide learning necessitated by high pressure on cost reduction as well as local responsiveness. • It is difficult to successfully implement due to high costs of control.

Source: ICFAI Research Center

2.8.2 Centralization Decision in International Business

In international business, issues like centralization and decentralization acquire a lot of importance. The centralization decisions taken by MNCs depending on the strategy of international business adopted are listed here.

- In MNCs adopting the international strategy, the parent organization in the home country might retain with itself the product development process; while strategic and financial decision making is centralized, marketing decisions may be decentralized.
- In an MNC adopting the multi-domestic strategy, subsidiaries adapt to local requirements by deciding production and marketing-related issues; while R&D decisions are usually centralized to maintain the parent organization's control over key technological and conceptual know-how.
- In global MNCs, decisions regarding location of production facilities, R&D, marketing, etc., are to a great extent centralized.
- Transnational MNCs need worldwide learning and good integrating mechanisms to simultaneously centralize decisions that help in cost competitiveness and decentralize decisions to ensure local responsiveness. Decentralization in these MNCs is adopted to the extent that foreign subsidiaries acquire such competencies as may be used by the parent organization and also by other subsidiaries.

2.8.3 Choice of Organization Structure for International Business

In addition to choosing the level and areas of centralization, an MNC has to decide the basis on which it will form its subsidiaries – product, operational location, or function. Most organizations which adopt a functional or a divisional structure in their home country, initiate their international operations by starting an international division. This division carries out all the operations related to international business. Later, subsidiaries are established and it may be effective to establish a worldwide structure. For example, a worldwide structure based on area may suit a multi-domestic strategy, and a worldwide structure based on product may suit a global strategy. However, these structures may have limitations in terms of higher costs or reduced responsiveness respectively, besides hindrances to worldwide learning.

Example: Samsung's Divisional Organizational Structure

Samsung's electronics division was solely accountable for its own conduct. The smartphone division was in charge of its own behaviour. Additionally, a company's city division may operate entirely independently of its other city division. Advertising, sales, production, secretarial, accounting and development personnel would be separate for each division. The divisional structure tended to make each level of management's job easier. It became simpler for them to assess divisional and employee performance and base their remuneration on performance.

Source: Structure of an enterprise explain with example, https://thairesidents.com/phqwhhd/structure-of-an-enterprise-explain-with-example June 15, 2021, (Accessed on July 2, 2022)

The limitations of global structures based on area or product resulted in MNCs adapting the transnational strategy which uses a global matrix structure. In this structure, the decision-making responsibility regarding the nature of product offering, marketing, and business strategies is borne by both the product division and the areas in which the product is being marketed. A particular manager becomes a part of both the divisional and product hierarchies and reports to two superiors. (We have explained the matrix structure earlier in the chapter.) However, such a structure also has serious limitations like disagreements and differences between the two hierarchies (product and area) and rigidities in decision-making procedures leading to slow responsiveness to market needs. These limitations may be overcome by adopting a flexible matrix structure which encourages informal networks / contacts between managers throughout the organization. Informal networks among managers of various subsidiaries encourage the unhindered flow of knowledge between subsidiaries and the parent organization and among subsidiaries. Advanced computerization and telecommunication technologies reduce the cost of maintaining such informal networks.

2.8.4 Designing Control Systems for International Business

The three control alternatives we have discussed earlier (action, results and personnel / cultural controls) are used in appropriate measures depending on the strategy adopted by an MNC (international, multi-domestic, global, or transnational). In general, the controllability of a subsidiary's results goes from high to low as we move from multi-domestic strategy to international strategy to global strategy to transnational strategy, as the interdependencies and the costs of control go from low to high. Thus, it is more appropriate to use results control for multi-domestic strategy and international strategy. Results controls may exist in the form of setting targets for the subsidiaries' managers which can be measured in terms of profitability, growth of business, relative market share in the host country, return on capital employed, etc.

For global strategy and transnational strategy, it is more appropriate to use action controls and personnel / cultural controls. Action controls may be implemented by the parent organization in the form of budgetary controls, limitations on capital expenditure and direct supervision of the subsidiaries. Action control mechanisms may bring about a consistency in the activities of the subsidiaries. If action controls involve extensive use of formal measures, it leads to the development of rigidity and the rise of conflicts among the subsidiaries.

Personnel / cultural controls are used in large measure to enable subsidiaries to imbibe the MNC's value system. This helps interdependent subsidiaries solve problems mutually without the intervention of the parent organization. These controls also bring about a substantial reduction in control costs, which would otherwise override the benefits of adopting the transnational or global strategy.

The nature of corporate control may also vary within the MNC from one subsidiary to another. We discussed the national culture as a context for management control systems. Exhibit 2.5 discusses the differences in control system between subsidiaries based on the nature of knowledge flows.

Exhibit 2.5: Knowledge Flows in International Business: Implications for Control Systems

The term knowledge flow refers primarily to two types of knowledge: management expertise, say, in procurement, design, promotional practices, channel management, etc.; and critical, market-related information that is of global importance to the MNC. The flow of administrative information between the subsidiaries and the headquarters is not considered as knowledge flow.

Subsidiaries can be classified based on two dimensions of knowledge flows: the extent to which the subsidiary uses the knowledge of the rest of the corporation (knowledge inflow), and the extent to which the subsidiary is a provider of knowledge for the other subsidiaries or the rest of the corporation (knowledge outflow).

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Thus subsidiaries can be classified into four types: Global Innovator (high outflow, low inflow); Integrated Player (high outflow, high inflow); Implementor (low outflow, high inflow); and Local Innovator (low outflow, low inflow). From a management control perspective, these subsidiaries differ in terms of lateral inter-dependence, global responsibility and authority, and the need for autonomous initiative.

Subsidiary differences in lateral inter-dependence: The inter-dependency between the subsidiary and the rest of the corporation will be a positive function of the extent of knowledge inflow as well as the extent of knowledge outflow. The extent of lateral inter-dependence with peers will be the highest for integrated players with high outflow and high inflow; intermediate for global innovators with high outflow and low inflow and implementors with low outflow and high inflow; and lowest for local innovators with low outflow and low inflow. Formal integrative mechanisms, well-established communication links, and corporate socialization of subsidiary managers enhance the information-processing capacity between two subsidiaries. The national cultures, from which the subsidiary managers originate, also influence the information processing capacity.

Subsidiary differences in global responsibility and authority: In an MNC, the managers' global responsibility goes beyond the direct formal authority over the activities undertaken within their own units because subsidiaries engage in knowledge transfers to other subsidiaries. From a corporate control perspective, it can be argued that appropriate mechanisms would motivate subsidiary managers to think of their responsibilities in either global or local terms or aim at preventing dissatisfaction among managers where their responsibility exceeds their authority. The scope of global responsibility will be higher for the subsidiaries with global innovator and integrated player roles than for those with implementor and local innovator roles. Gaps between responsibility and authority are usually greater among global innovators and integrated players than they are for implementors and local innovators. As the global responsibility is much higher for global innovators and integrated players, they require more of action controls than results controls, and the results monitored should reflect their global responsibility and not just the performance of the individual subsidiary. They also require greater flexibility in budget-based evaluation than implementors and local innovators.

Subsidiary differences in need for autonomous initiative: As the magnitude and scope of knowledge creation expected from a subsidiary increases, the need for more autonomous initiative from the subsidiary also increases. The need for autonomous initiative is highest for global innovators, intermediate for integrated players and local innovators, and lowest for implementors.

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From the perspective of management control, the relevant control mechanisms would be those that allow for differentiation to the extent the subsidiary managers are allowed to take initiatives, given recognition for exercising their initiatives, and be rewarded for doing so. For instance, the proportion of variable pay (in the overall managerial compensation) would be high for global innovators, intermediate for integrated players and local innovators, and low for implementors.

Source: Adapted from Anil K. Gupta and Vijay Govindarajan, "Knowledge Flows and the Structure of Control within Multinational Corporations," Academy of Management Review, vol. 16, no. 4, 1991, pp.768-792.

The following example provides an understanding on the working of trans-nationals.

Example: Trans-Nationals

Trans-national organizations have greater coordination and low control spread throughout the organization. Following are the implementation tactics for executing the trans-national model.

- Synergies from mass customization gained through global R&D (e.g., American Express, Time Warner, Frito-Lay)
- Global sourcing and logistics (e.g., Benetton, Citicorp)
- Global intelligence and information resources (e.g., Andersen Consulting, McKinsey Consulting)
- Global customer service (e.g., American Express)
- Global alliances (e.g., British Airways and US Air; KLM and Northwest)\

Source: Adapted from "Transnational Organizatian," <http://www.referencefarbusiness.cam/management/Tr-Z/Transnati0nal-Organization.html>

2.9 Management Control of Non-Profit Organizations

The many differences that are seen in the operations of for-profit businesses and non-profit organizations give rise to problems in non-profit organizations that are quite different from those in the for-profit businesses. Obtaining funds to run the operations is often the main issue for non-profit organizations. Leaders of non-profit organizations may think that a service which has a good cause will sell by itself; as a result, they may not pay much attention to deciding the features of the service, the strategies for selling them, the mode of delivering the services, etc. The employees and volunteers who work for the organization get the satisfaction that they have worked for a good cause. Because of this, they tend to neglect the fact that conscious effort is required to sell the service. In a product-based manufacturing business, the customer has a major influence on the way the product is designed. For a service-based non-profit organization, the services are usually intended to benefit other human beings. A prevalent belief in many non-profit organizations is that the service provider can decide on the features of the service without taking inputs and feedback from the intended beneficiaries. This could lead to a flawed design of the service product.

Another problem faced by non-profit organizations is that of service delivery. Lack of proper reward systems, poor communication and relationships between members, or lack of support and encouragement from the top management may lead to poor service delivery. Also, very few non-profit organizations have significant monetary incentives for motivating employees and volunteers. Due to the fundamental differences that exist between for-profit and non-profit organizations, it is not sufficient to merely extend controls used in the former to the latter. In this section, we discuss the criteria for management control of non-profit organizations and the choice of control type based on these criteria.

Geert Hofstede discussed the different criteria which help in management control of public / non-profit organizations and how different control systems are possible depending on these criteria. Clear objectives, quantifiable results, predictable interfaces, and activities that can be repeated are some criteria which help in better management control. Different combinations of the four criteria give rise to different types of controls which are: routine control, expert control, trial and error control, intuitive control, judgmental control, and political control. Refer to Table 2.5 for the suggested type of control for each scenario. Although these types of controls can be used in any type of organization, we have restricted their scope to public / non-profit organizations as represented by Hofstede (Refer Table 2.6).

Table 2.5: Types of Controls for Non-Profit Organizations

Scenario	Clarity of objectives	Quantifiability of results	Predictability of interfaces	Repetitiveness of activities	Suggested type of control
1	Yes	Yes	Yes	Yes	Routine control
2	Yes	Yes	Yes	No	Expert control
3	Yes	Yes	No	Yes	Trial and error control
4	Yes	Yes	No	No	Intuitive control
5	Yes	No			Judgmental control
6	No				Political control

Source: Adapted from GeertHofstede, "Management Control of Public and Not-for-Profit Activities," Accounting, Organizations and Society, vol. 6, issue 3, pp.193-211, 1981

Table 2.6: Controls for Public / NPOs and Their Description

Type of Control	Description
Routine control	• Clear objectives, quantifiable results, predictable interfaces, and repetitive activities. • It is institutionalized in the form of standard operating procedures and rule books. • Control activities can be performed manually or they can be automated.
Expert control	• Clear objectives, quantifiable results, predictable interfaces, and non-repetitive activities. • Experts are people who have in-depth knowledge about the procedures and processes and hence are capable of exercising control.
Trial and error control	• Clear objectives, quantifiable results, unpredictable interfaces, and repetitive activities. • Standard operating procedures cannot be devised as they come into play in activities like new product launch.
Intuitive control	• Clear objectives, quantifiable results, unpredictable interfaces, and non-repetitive activities. • Commonly seen in project-based non-profit organizations where each new project is unique and each project has to be approved by the top management.
Judgmental control	• When the objectives are clear, but the results are not quantifiable, it is necessary to see whether other forms of control mechanisms can be put to use. If it is not possible, the control becomes judgmental and is dependent on the hierarchical structure and authority that the management has.
Political control	• If objectives are unclear, the control used is political control. • It is dependent on the hierarchical structure, negotiation, availability of resources, and the differences of opinion regarding values and objectives. • Generally works at the top level where the objectives get clarified. • As the objectives cascade down the system, other forms of control can be incorporated at the lower levels.

Source: ICFAI Research Center

Activity 2.3 Mercy Charities is a non-profit organization (NPO) in Goa which participates actively in the upliftment of the fishermen community there. It has been receiving donations from quite a few international organizations. In order to be able to make better use of the resources, the management decides to design and implement a proper management control system. How is it possible to control the activities of an NPO? What are the types of controls that can be implemented in an NPO? **Answer:**

2.10 Control Systems for Empowerment, Innovation and Creativity

In this modern day and age, where the business environment is complex, competition tough and, talent scarce and expensive, managers have to strike the right balance between empowerment and control. One method is to follow a system where employees are told how to do their jobs and are monitored constantly. However, in organizations which operate in a highly complex and dynamic environment, this method of managing employees may neither be feasible nor effective.

Managers must find ways to encourage employees to be creative and to initiate process improvements, but must still retain enough control to ensure that employee creativity benefits the organization. To address this issue, the concept of 'levers of control' was proposed by Robert Simons in 1995. According to him, diagnostic control systems, belief systems, boundary systems, and interactive control systems are the four levers of control used in management. Table 2.7 gives an overview of the four levers of control.

Table 2.7: Levers of Control

Organizational problem	Managerial solution	Lever of control
Lack of focus or resources to accomplish objectives	Communicate clear targets; provide the necessary support and feedback	Diagnostic control systems

Contd….

Ambiguity of purpose	Convey core values and mission	Belief systems
Pressure or temptation to act illegally or unethically	Indicate and enforce rules	Boundary systems
Suppressed creativity due to lack of prospects or fear of risk	Open communication between functions to encourage organizational learning	Interactive control systems

Source: Adapted from Robert Simons, "Control in an Age of Empowerment," Harvard Business Review, vol. 73, issue 2, Mar/Apr 1995, p.83.

All the four levers of control are linked. Having just the diagnostic control system or the belief system in place will not help in bringing about better performance. The four levers of control can help managers not only in motivating people to be creative, but also in enforcing the control systems of the organization effectively.

2.10.1 Diagnostic Control Systems

Diagnostic control systems use quantitative data, statistical analyses and variance analyses to scan for anything unusual that might indicate a potential problem. Employee rewards are often based on how well performance goals have been met. Diagnostic systems work well if the goals are reasonable and attainable. Diagnostic control systems relieve managers of the task of constantly monitoring employees and are very useful for detecting problems. Employees usually have a high degree of freedom to adopt creative means to achieve their targets.

However, when goals are unrealistic, empowered employees may sometimes use their creativity to manipulate the factors under their control to live up to their manager's expectations. Such manipulations have only very short-term positive effects, and can lead to long-run disaster for the organization. One good example of unethical behavior to meet pre-set goals is a medical representative giving discounts or schemes other than those approved by the organization to meet sales targets. It is necessary that organizations have the right number of measures to evaluate employees and also proper controls to check that no unethical means are used to achieve targets.

Belief Systems

Belief systems are used to communicate the doctrines of the corporate culture to every employee of the organization. Belief systems are generally broad and designed to appeal to different groups working in different departments, and to inspire and promote commitment to the organization's core values. For belief systems to be an effective lever of control, employees must be able to see key values and ethics in the same light as the managers and other people in high positions in the organization. Senior management must be careful not to adopt a particular belief or mission simply because it is in vogue, but rather because it reflects the true nature and value system of the organization as a whole. In other words, the vision and mission statements of an organization are formal expressions of its belief systems. Exhibit 2.6 describes the unique organizational culture at Pixar that encouraged its employees to be innovative and contributed to its creative success. It is important that the organizations make employees understand their belief systems so that they can contribute to the objectives of the organization as a whole. Belief systems tell the employees the activities they should take up to help the organization achieve its objectives. But it is also necessary to tell them what they should not do, as for example, not to give or take bribes. This aspect is addressed by 'boundary systems'.

Boundary Systems

Boundary systems are based on the principle that in an age of empowered employees, it is easier and more effective to set the rules regarding what is inappropriate rather than what is appropriate. The effect of this kind of thinking is to allow employees to create and define new solutions and methods within defined constraints. Boundary systems work on the premise that empowered employees should not be given the freedom to do whatever they want. Employees should focus their efforts on areas that are in the interests of the organization in terms of profitability, productivity and efficiency.

Boundary systems are thus "minimum standards" that the employees have to maintain. Examples of these kinds of standards include, forbidding employees to discuss client matters outside the office or with anyone not employed by the organization, and encouraging them not to accept work on projects or with clients deemed to be undesirable. Often, organizations implement boundary systems only after they have suffered a major crisis due to the lack of such a system. It is important that organizations are proactive in establishing boundaries. In other words, the code of conduct of the organization acts as a boundary system.

Boundary systems have an approach to control that is in direct contrast to that of diagnostic control systems or belief systems, in the sense that boundaries are stated in negative terms whereas diagnostic and belief systems are positive and inspirational. For example, the code of ethics of the organization acts as a 'boundary constraint' and states the responsibilities of the employees while complying with the policies and procedures and the rules about complying with the law. The code also specifies the conduct employees should follow with business partners, etc.

Interactive Control Systems

Interactive control systems are futuristic and involve frequent communication between top managers. The interactive control system helps organizations in positioning themselves strategically in the rapidly changing market. Performance management, budgeting, brand management, etc., are a few interactive control systems. The top management chooses which of them are to be focused on to bring about the necessary control in the organization.

There are four characteristics of interactive control systems:

- They focus on information like technologies, government policies, competitor activities, and customer preferences, which are ever changing.
- This information is vital to all managers at all organizational levels.
- The information and data generated by the interactive control systems have to be discussed at open meetings between all organizational levels.
- Interactive control systems help in healthy discussions about the assumptions of the top management and action plans intended.

Check Your Progress - 2

6. According to the nature of monetary inputs and outputs, responsibility centers can be classified into four types. Which of the following is not one of these four types?
   a. Cost center
   b. Revenue center
   c. Profit center
   d. Quality center
   e. Investment center
7. In situations in which accepted norms for actions cannot be formed, what are useful for assessing the outcomes?
   a. Personnel / cultural controls
   b. Expert controls
   c. Results controls
   d. Judgmental controls
   e. Span of control
8. According to Christopher Bartlett and Sumantra Ghoshal, organizations can choose from one of four strategies for doing international business. Among these strategies, the international strategy involves:
   a. Adapting to local requirements by customizing both product and marketing strategy.

b. Transferring know-how and / or products developed in the home country to foreign markets where they are scarce or unavailable.

c. Focusing on cost reduction by selecting locations for value addition based on the objective of minimizing costs and achieving economies of scale along with the beneficial effects of learning and experience.

d. Achieving both cost reduction and local adaptability while encouraging a two-way flow of know-how between the parent company and subsidiary.

e. Transferring know-how and / or products developed in the home country to foreign markets where they are abundantly available.

9. Taking into consideration Hofstede's criteria for better management control in non-profit organizations, identify the type of control to be used when the objectives of the organization are unclear.

   a. Routine control
   b. Political control
   c. Judgmental control
   d. Trial and error control
   e. Span of control

10. The concept of levers of control was proposed by Robert Simons in 1995. According to this concept, what is a control lever used in a problem situation where there is lack of focus or resources to accomplish objectives.

   a. Interactive control system
   b. Boundary system
   c. Belief system
   d. Diagnostic control system
   e. Business process reengineering

2.11 Summary

- Organizations are led by living persons. Their behavior varies owing to different circumstances and situations. Thus, the manager is a person who manages his subordinates to carry out their work in the interest of organization objectives.
- Every manager has his unique style of managing his subordinates. His style depends upon the prevalent work culture and targeted objectives of an organization. This is known as "Management Style'.
- The different management styles are autocratic style, paternalistic style, democratic style, laissez-faire style, and management by walking around style.

- The different dimensions of management style have an impact on the management control systems of an organization. The former is the replica of the latter.
- Management Control Systems establish a certain set of norms, values, procedures, and policies that are influenced by the organization culture. Alternatively, Management Control System influences the organization culture through defined process flows, policies and procedures.
- The main purpose of management control system is goal congruence. The decisions of the managers should be consistent with the objectives of the organization.
- Controller is a person responsible for designing and operating management control system. Chief Financial Officer is normally designated as a Controller.
- Organization structure refers to the role-responsibility relationships of different employees in an organization, along with their pre-defined interaction patterns.
- The structural dimensions of organization design are —formalization, specialization, hierarchy of authority, centralization, professionalism, and personnel ratios.
- The various types of organization structures include —functional, divisional, matrix, horizontal, and hybrid structures.
- A responsibility structure is a collection of responsibility centers. A responsibility center is a function, division, or unit of an organization under a specified authority with a specified responsibility.
- In an organizational setting, it is necessary that the performance measurement systems are designed to be fair. Two major aspects to be considered are controllability and goal congruence. Transfer pricing is a tool used in responsibility accounting to assign monetary values to transactions taking place between two or more responsibility centers.
- According to the nature of monetary inputs and outputs, responsibility centers can be classified into four types —cost centers (further divided into standard cost centers and discretionary expense centers), revenue centers, profit centers, and investment centers.
- Designing an optimal MCS involves determining the specific control measures to be used and the degree of tightness or looseness of control required to provide the desired level of certainty of achievement of objectives.
- An organization may choose any one or a combination of action control, results control, and personnel / cultural control.

- Decision about control alternatives to be used involves an analysis of the structural and contextual factors which influence control systems and also doing a cost-benefit analysis.
- While designing the organization structure of an MNC, it is important to consider the following three aspects —the strategy of international business, extent of centralization and the division of an MNC into subsidiaries based on product, operational location, or function.
- Organizations can choose from one of the following four strategies for doing international business —international strategy, multi-domestic strategy, global strategy, or transnational strategy—based on the pressure on cost competitiveness, pressure for local responsiveness and the need for worldwide learning.
- In terms of organization structure of the MNC, global structures based on the area or product, are common. Limitations in these structures resulted in MNCs adopting the transnational strategy which uses a global matrix structure.
- Management control of non-profit organizations is an area distinguishable from that in for-profit organizations because of the inherent difference with respect to the source of funds, features of service, the strategies for selling the service, the mode of delivering the services, reward systems for employees, etc.
- According to Geert Hofstede, four criteria which determine the nature of management control of non-profit organizations are clarity of objectives, quantifiability of results, predictability of interfaces, and repetitiveness of activities.
- NPOs can adopt different types of controls —routine control, expert control, trial and error control, intuitive control, judgmental control, and political control.
- Managers must find ways to encourage employees to be creative and to initiate process improvements, but must still retain enough control to ensure that employee creativity benefits the organization. Robert Simons' concept of 'levers of control' aims at addressing this issue. The four levers of control are diagnostic control systems, belief systems, boundary systems, and interactive control systems.

2.12 Glossary

Autocratic Style of Working: The superiors do not take into consideration the ideas and suggestions of the subordinates. The managers, leaders and superiors have the sole responsibility of taking decisions without bothering much about the subordinates.

Cost Center: Cost centers are held responsible for the costs incurred, and they are not held responsible for generating revenue. A cost center can operate in two ways: either the cost budget is specified and the goal is to maximize the output, or the expected output is specified and the goal is to minimize the cost.

Democratic Style of Working: Superiors welcome the feedback of the subordinates. Employees are invited on an open forum to discuss the pros and cons of plans and ideas.

Divisional Structure: In divisional structure, the divisions are formed based on a company's product range, the specific markets which a company caters to, or the geographic locations in which a company operates. In such a structure, each division independently handles a separate product, market, or geographic location. It is also known as a product structure or strategic business units (SBUs).

Functional Organization Structure: A functional organization structure is characterized by grouping people based on their expertise and skills. In a functional structure, the vertical hierarchy is stronger than the horizontal hierarchy. The functional structure calls for centralization as the decisions regarding resolution of issues are generally made by the top management.

Horizontal Structure: The horizontal organization structure prevents the rigidity and departmentalization existing in a vertical system by grouping managers and employees into synergistic teams for problem-solving.

Hybrid Structure: Most organizations use a combination of the functional, divisional, or horizontal structures. Such combination structures are known as hybrid structures. They help organizations to combine the strengths of different structures while eliminating the weaknesses of each. These are also known as flexible or adaptive organizations as they can quickly adapt to changes in an extremely volatile environment.

Investment Center: Investment centers are held responsible for the overall economic performance in terms of the cost incurred, the revenue generated, as well as the associated investment. The performance of investment centers is measured with respect to Return on Investment (ROI) or Return on Capital Employed (ROCE) (which is arrived at by dividing profit by the capital employed in making that profit) and Economic Value Added (EVA).

Laissez-Faire Style of Working: Managers are employed, but with no say and do not contribute much to the organization. The employees take decisions and manage work on their own.

Management by Walking around Style of Working: Managers treat themselves as an essential part of the team and are efficient listeners. Superiors interact with the employees more often to find out their concerns and suggestions.

Matrix Organization Structure: The matrix organization structure tries to integrate the desired features of the functional structure (say, technical specialization) and divisional structure (say, market responsiveness, product innovation, or project delivery). In this structure, an employee reports simultaneously to two different supervisors.

Organization Structure: Organization structure refers to the role-responsibility relationships of different employees in an organization, along with their pre-defined interaction patterns. It specifies how individual employees should be teamed together to form sub-groups within the organization, and the formal techniques and methods of communication and coordination to be used in the organization.

Paternalistic Style of Working: In paternalistic style of working, the leaders decide what is best for the employees as well as the organization. Policies are devised to benefit the employees and the organization.

Process: Process in a horizontal structure stands for an organized group of related tasks and activities that work together to transform inputs into outputs that create value for customers.

Profit Centers: Profit centers are those responsibility centers, which are responsible for profits. The manager of a profit center has control over both the input (cost of resources) as well as the output (revenue earned).

Responsibility Center: A responsibility center can be defined as a segment of the organization where an individual manager is held responsible for the segment's performance. It is a department, function, or unit of an organization headed by a manager who is directly answerable for its performance.

Responsibility Structure: A responsibility structure is a collection of responsibility centers. Each responsibility center is a function, division, or unit of an organization under a specified authority with a specified responsibility.

Revenue Center: In revenue centers, managers are held responsible for the revenues (outputs). Generally, these centers are not directly responsible for profits. The main objective of revenue centers is to maximize net revenues.

Standard Cost Center: Standard cost center is a kind of responsibility center which is usually found where a standard cost system is in place, usually in manufacturing organizations or in service organizations that have a repetitive task to be performed. It is also referred to as an engineered expense center.

Structural Dimensions: Structural dimensions are entirely internal to the organization and are used as a basis for formally describing the organization structure. According to Richard L. Daft, the different structural dimensions are—formalization, specialization, hierarchy of authority, centralization, professionalism, and personnel ratios.

2.13 Self-Assessment Exercises

1. To promote communication, cooperation, team-work, motivation, and performance, the organization design should be best fitted to the organization, and its external and internal environments. Discuss Daft's six structural dimensions in the light of this statement.
2. The organization structure should encourage participation and innovation over and above maximization of performance levels and effectiveness of operations throughout the organization. What are the various types of organization structure? Discuss the advantages and disadvantages of each of these structures.
3. Whatever the type of organization structure, it is true that the MCS throughout an organization cannot be the responsibility of a single individual. Do you agree with the statement? Give reasons for your answer based on the principles of controllability and goal congruence in designing responsibility structures in organizations. Also state how transfer pricing is used to measure the individual center's contribution to the overall organizational goals.
4. What are the responsibility centers? Explain how responsibility centers may be classified according to the nature of monetary inputs and outputs.
5. Designing the organization structure of an MNC entails taking many decisions on three main aspects. Enumerate and explain these aspects in the light of Bartlett and Ghoshal's alternative strategies for doing international business.
6. Philip Kotler defines Control Process as "the process of taking steps to bring actual results and desired results closer together." Discuss in detail the characteristics of a Control System.
7. Describe the informal factors that affect the goal congruence.
8. Discuss how different control systems are possible in non-profit organizations based on Hofstede's criteria for categorizing public / non-profit organizations.

2.14 Suggested Readings / Reference Material

1. Stephen P Robbins, David A. De Cenzo and Mary Coulter. *Fundamentals of Management: Essential Concepts and Applications*, Fifteenth Edition| By Pearson Paperback – 30 June 2022.
2. Subhash Chandra Das, Management Control Systems – Principles and Practices, PHI Learning Pvt. Limited, Paperback – 15 July 2019.
3. Pravin Durai, Principles of Management: Text and Cases, First edition, Pearson India Education Services Pvt. Ltd.; Second edition (31 August 2019)
4. Xianzhi Zhang, Enterprise Management Control Systems in China, First edition, Springer-Verlag Berlin Heidelberg, 23 Sep 2016.

5. Prof. Kenneth Merchant and Prof. Wim Van der Stede, Management Control Systems: Performance Measurement, Evaluation and Incentives, Third edition, Prentice Hall, 2011.

2.15 Answers to Check Your Progress

1. (a) Functional structure

In functional structure, each manager is responsible for a specified function such as production or marketing.

2. (c) Span of control

Hierarchy of authority refers to the reporting relationships prevalent in the organization and the span of control. The span of control is defined as the number of subordinates who report to a supervisor. Centralization refers to the level in the hierarchy which has the decision-making authority. Personnel ratios refer to the distribution of people into different functions and departments. When the decision-making authority is distributed among the lower levels of the hierarchy, the organization is said to be decentralized.

3. (b) Hierarchy of authority

Hierarchy of authority describes the reporting relationships prevalent in the organization and the span of control. Formalization refers to the extent to which written rules and records are maintained in the organization. Specialization is the level to which organizational activities are divided into sub-groups. Centralization talks about the level in the hierarchy which has the decision-making authority.

4. (b) Functional structure

The functional structure is characterized by people being grouped based on their skills and expertise. The divisional organization structure is made up of divisions formed based on an organization’s product range, the specific markets to which the organization caters, or the geographic location in which it operates. The matrix structure tries to integrate both the functional and divisional structures. For hybrid organizations, the decision on organizational design is taken based on which structure is appropriate in a specific situation and at a particular point in time.

5. (d) Business process re-engineering

The horizontal organization structure helps in preventing the rigidity and departmentalization existing in the traditional vertical structures by grouping managers and employees into synergistic teams for problem solving. Business process re-engineering is used by organizations to shift toward a horizontal organization structure.

6. (d) Quality center

Responsibility centers facilitate management control and help in implementing the strategies chosen to accomplish the organization's goals. According to the nature of monetary inputs and outputs, they may be classified into —cost centers (which are further divided into standard cost centers and discretionary expense centers), revenue centers, profit centers, and investment centers.

7. (c) Results controls

Results controls direct focus on the output of actions. These controls do not restrict creativity as they do not place limits on actions. They aim at ensuring that even new, innovative ideas and processes achieve desirable results.

8. (b) Transferring know-how and / or products developed in the home country to foreign markets where they are scarce or unavailable

The international strategy involves transfer of know-how and / or products developed in the home country to foreign markets where they are scarce or unavailable. A multi-domestic strategy involves adapting to local requirements by customizing both product and marketing strategy. In this strategy, there is usually a poor flow of know-how between the parent organization and the subsidiary. In the global strategy, the focus is on cost reduction by selecting locations for value addition based on the objective of minimizing costs and achieving economies of scale along with the beneficial effects of learning and experience. There is usually a one-way flow of know-how from the parent organization to the subsidiary in this case. The transnational strategy aims at achieving both cost reduction and local adaptability while encouraging a two-way flow of know-how between the parent organization and subsidiary.

9. (b) Political control

Political control is used when the objectives of the organization are unclear. Routine controls are used when objectives are clear, results quantifiable, interfaces predictable, and actions repetitive. When the objectives are clear, but the results are not quantifiable, it is necessary to see whether other forms of control mechanisms can be put to use. If it is not possible, the control becomes judgmental and is dependent on the hierarchical structure and authority that the management has. Trial and error controls are used when the outcome of the interfaces is not known even though all the other criteria are fulfilled.

10. (d) Diagnostic control system

Diagnostic control systems use quantitative data, statistical analyses and variance analyses to scan for anything unusual that might indicate a potential problem. These systems work well if the goals are reasonable and attainable. They relieve managers of the task of constantly monitoring employees and are very useful for detecting problems. Employees usually have a high degree of freedom to adopt creative means to achieve their targets. Belief systems are used in situations where there is ambiguity of purpose. They communicate the core values and the mission to every employee of the organization. Boundary systems are apt where there is pressure to act illegally or unethically. They communicate the minimum standards that the employees have to maintain. Interactive control systems are most suitable when there is suppressed creativity due to lack of prospects or fear of risk.

Unit 3

Organizational Culture

Structure

"Company cultures are like country cultures. Never try to change one. Try, instead, to work with what you've got."

- Peter F. Drucker, Austrian-American management consultant, educator, and author

3.1 Introduction

Be a Roman when you are in Rome It is always important that the policies, practices, processes etc. that any organization formulates & implements should identify with the values with which the business is run and also with the statutory / regulatory framework of that particular country where the business is run.

In the previous unit, we discussed power and politics in which we talked about the bases of power, contingency approaches to power and organizational politics. In this unit, we will discuss organizational culture.

Culture is learned behavior. Organizations develop a culture of their own over a period. The culture of an organization makes it distinct from other organizations. The organizational culture influences the behavior of employees working for the organization and, to an extent, has an influence on people in society at large. Hence, understanding organizational culture gives an insight into the behavior of people in general. This unit will explain the characteristics of organizational culture, describe types of culture, and will discuss changing organizational culture and the connectivity between management controls within the organization and the organization culture.

3.2 Objectives

After studying this unit, you should be able to:

- Define organizational culture
- Describe characteristics of organizational culture
- Classify culture
- Discuss changing organizational culture
- Identify the connectivity between organization culture and management controls

3.3 Definition of Organizational Culture

Conceptual understanding of organizational culture is important.

Organizational culture refers to a pattern of learned behaviors that is shared and passed on among the members of an organization. It comprises the various assumptions, values, beliefs, norms, rituals, language, etc. that people in an organization share. It can be thought of as an evolutionary process that has been established, accepted, and internalized over a period by a majority of members of the organization.

Edgar Schein defined organizational culture as "a pattern of shared basic assumptions that the group learned as it solved its problems of external adaptation and internal integration that has worked well enough to be considered valid, and therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those problems". Different organizations have different cultures and influence the behavior of individuals differently. In fact, organizational culture creates a distinct identity for individuals working for an organization.

Example: How Jeff Bezos Consistently Communicates Four Core Values that Made Amazon a Success

Former Amazon executives Bill Carr and Colin Bryar, who worked there for almost 27 years, were the co-authors of the new book Working Backwards.

Contd....

Bryar served as Bezos' chief of staff for two years, serving as his "shadow" for nine hours every day. He was a member of Amazon's senior leadership team. Carr launched Amazon Music, Prime Video and Amazon Studios as vice president of digital media. The four components of customer focus, long-term thinking, innovation zeal and pride in operational excellence made up Amazon's culture. These four corporate culture pillars of Amazon were included into every process, conversation, and supported by the highest leadership. These principles were a major factor in Amazon reaching $100 billion in annual sales for the first time in the world in 2015.

Source https://www.forbes.com/sites/carminegallo/2021/02/11/how-jeff-bezos-consistently-communicates-four-core-values-that-made-amazon-a-success/?sh=2204770f6e24, Feb 11, 2021. Accessed on 14 July 2022

3.4 Characteristics of Organizational Culture

Organizational culture guides the behavior of employees and has a list of characteristics as discussed below.

Norms

Norms relate to the standards of behavior and guidelines on the quantum and quality of work that every employee in an organization must deliver. These standards of behavior must be adhered to in order to preserve the organizational culture. Several norms are set depending on the nature of work in organizations. For instance, some sales agencies may have a norm that their tele-marketers should make at least 100 calls per day.

Innovation and risk taking

Some organizations develop a culture to generate innovative ideas by encouraging employees to take more risks at work. They invest a lot of money in R&D (Research and Development). Examples of organizations (which have this characteristic of organizational culture) are - Nokia Corporation, Dr. Reddy's Laboratories, etc.

Attention to detail

The organizational cultures of some organizations emphasize precision and attention to detail as per the requirements of the job.

Outcome orientation

An outcome of the process is stressed in some organizations without importance being given to the ways and means of getting them. This characteristic may sometimes encourage unethical behavior in employees.

People orientation

People orientation refers to the degree to which the management takes into consideration, the effect of decisions made and the influences of these decisions on the people in the organization. Organizations with a people-oriented culture encourage employee participation in the decision-making process. In fact, employee welfare is given due importance and provision of facilities such as houses, schools, medical, and recreational facilities are arranged by the organization.

Team orientation

This characteristic of organizational culture emphasizes the efforts of teams at work over and above individual contributions. Organizations such as Colgate encourage global teams to work together and find a solution to problems which have an impact on organizational functioning.

Observed behavioral regularities

The interactions between employees of an organization are guided and controlled by behavioral regularities. The commonly observed behavioral regularities are language, terminology, symbols, rituals, etc.

Dominant values

The values on which organizations are built and are expected to be adopted by all employees of the organization are termed as dominant values. For example, one organization may give importance to professionalism while another may insist on globalization.

Rules

Organizations lay down strict guidelines for new employees to make them aware of how to get along in the organization and how to become accepted as members of the organization. All newcomers are expected to quickly learn the ‘ropes’ to perform their assigned activities efficiently.

Philosophy

Philosophy is the policy the organization adopts in treating its employees and customers. It also refers to the values adopted by organizations and differs from one organization to another. The following example is an illustrative to it.

Example: What makes a Great Work Culture?

Google was excellent at assisting its employees with money management not simply in the conventional sense. In addition to offering each employee a fair wage, Google also had financial consultants on staff. The financial advisors at Google were on hand to aid their employees with anything from taxes and debt management to helping them manage assets. This made it a fantastic approach to give their workers more financial stability. Google had always made a point of employing people who aren't afraid to express their ideas.

Contd….

It's essential that staff members took advantage of the chance to provide honest criticism because everyone has a direct channel of communication with the official level. This was why the willingness to provide candid criticism was among the most crucial traits in new workers (apart from competence, of course). Overall, Google was at the centre of not only resolving day-to-day issues but also of their own employees through an immersive, deeply ingrained work culture by providing - a) Financial security for employees; b) Flat organizational infrastructure; and c) Equal opportunities for employees to provide feedback.

Source: https://www.zavvy.io/blog/company-culture-examples, 1 July 2022 | Accessed on 19 July 2022 |

Organizational climate

Organizational climate refers to the overall impression of an employee in an organization and his/her experiences. It is because of the physical layout of the office or plant, the way people interact, and the way employees behave with customers. Some organizations want to encourage a stress-free working environment and provide recreational and relaxation facilities at the workplace to provide an enjoyable organizational climate to employees. For example, organizations such as Microsoft Corporation, Cadbury Schweppes etc., have a cafeteria, gym, swimming pool, table tennis tables, billiards, and other recreational facilities at the workplace that allow employees to relax and play during office hours.

Check Your Progress - 1

1. Which of the following does not relate to organization culture?
   a. Ad hoc occurrences and actions with minimum acceptance.
   b. Pattern of learned behavior that is shared and passed on.
   c. Sharing values, beliefs, languages, etc.
   d. Processes considered valid that have been internalized across the organization.
   e. Transferable into a common practice.
2. In the context of Organizational Culture, which of the following can be classified under behavioral regularities?
   i. Employees do not rush in to cubicles of colleagues but gently knock and then enter.
   ii. Employees make it a point to display their ID cards whenever they are in the company premises.

iii. Birthdays of employees are celebrated by arranging for bouquets and a gift packet with some informal celebrations.

iv. The correspondence between a company and its client varies from one instance to another.

a. Only i, ii, and iii

b. Only ii and iii

c. Only ii and iv

d. Only iv

e. Only iii

3. What refers to the strict guidelines for new employees to make them aware of how to get along in the organization and how to become accepted as members of the organization.

   a. Rules

   b. Norms

   c. Dominant values

   d. Team orientation

   e. Training

4. In an organization, which of the following refers to the standard of behavior every employee has to follow on the quantum and quality of work to be delivered?

   a. Organizational culture

   b. Norms

   c. Values

   d. Assumptions

   e. Rules

5. What is the degree to which the management takes into consideration, the effect of decisions made and the outcomes of these decisions on the people in the organization?

   a. Outcome orientation

   b. People orientation

   c. Team orientation

   d. Production orientation

   e. Marketing orientation

3. 5 Uniformity of Culture

A composite collection of people belonging to different social and regional cultures in an organization results in a variation to the extent to which the values and culture hold a shared meaning and a common perception for all members. It is quite natural that there will be variation in the attitude of an organization's members. This variation results in a dominant culture and a subculture within the organization.

Dominant culture

This is the culture that a large number of employees in an organization adopt. The dominant culture guides the interpretation of organizational policies and procedures. It has an impact on the consensus of opinions. The general behavior at the workplace is guided by the dominant culture.

Subculture

Subculture is a culture adopted by a minority group or small groups within the organization. Large organizations usually have subcultures. Subcultures are formed when people meet others with whom they can identify, and form various social categories or groups based on age, occupational or professional skills, union membership, etc. Sometimes, people who oppose the dominant culture of the organization may adopt cultures which are modifications of the dominant culture or even cultures that contradict the dominant culture.

Example: Subcultures at Granny's Pie Factory

Employees at the 2006-founded Granny's Pie Factory in Connecticut adhere to the norms of the prevailing culture. Although they shared a common workspace, they operate out of different buildings, and this physical separation highlights the importance of collaboration among the bakers ensured that the pies were baked to perfection. The senior management, which includes the CEO, CFO, Treasurer, and other Vice Presidents, drove the goal of sustaining Granny's Pie's financial health despite the fact that the staff members worked in the same office building, no other office employees attend their meetings.

Source:https://study.com/academy/lesson/organizational-subculture-definition-examples.html.; © copyright 2003-2022, Accessed on 2 November 2022

3.6. Strong Vs Weak Cultures

The organizational culture can be termed as strong or weak depending upon the degree of sharedness and intensity of adaptation of a common culture by the employees of the organization.

Sharedness

The acceptance level of the organizational culture and the degree of sharedness make the culture of an organization strong or weak. The greater the sharedness of the culture, the stronger will be the organizational culture. The degree of sharedness is affected by the orientation the employees receive when they join the organization, and also by the organizational reward system. The new employees of the organizations can be helped through induction programs. This facilitates the adoption of shared values and helps in increasing the sharedness of culture among employees.

Example: Pixar's Creative & Collaborative Culture

American computer animation company Pixar was renowned for its critically acclaimed and financially lucrative computer animated feature films. No company understood the fragility of originality more than Pixar, according to co-founder of the company Ed Catmull. To see the possibilities of "ugly infants and early new-borns," you need a strange culture. The key to Pixar's success was striking a balance between cooperation and originality. While the majority of creative businesses encourage internal rivalry, Pixar took a different track. To assist enhance the ideas of other teams, co-workers gave comments to one another. By displaying unfinished work, it was anticipated that people would become accustomed to feeling uncomfortable in public. Pixar engaged in radical transparency to encourage open dialogue. Colleagues should evaluate the work rather than their co-workers. Together, they contributed to transforming unattractive new-borns into beautiful ones. Respect was shown between people. Nobody, however, held back in order to be courteous. In order to foster and support the initial iterations of creativity before turning them into beautiful products, this encouraged psychological safety.

Source: https://www.fearlessculture.design/blog-posts/11-examples-of-companies-with-powerful-cultures, December 7, 2020 | Accessed on 14 July 2022

Intensity

Intensity of culture refers to the degree of commitment from the employees to the core values of the organization. When the intensity of culture is high, employees adhere strictly to the organizational culture. The reward system in the organization also has an impact on the intensity of culture.

Activity 3.1:

Explain the type of culture which you feel is dominantly prevalent in your business. Support your view with the help of some examples.

Answer:

Check Your Progress - 2

6. Identify the variations in the extent of sharing of organization culture and its values among employees?
   a. Dominant culture, subculture
   b. Dominant culture, simple culture
   c. Simple culture, dormant culture
   d. Dormant culture, dominant culture
   e. Dormant culture, simple culture
7. What is the extent of shared values limited to a small portion of an organization and the characteristic of an organizations it refers to?
   a. Subculture, large
   b. Subculture, small
   c. Dominant culture, large
   d. Organization culture, small
   e. Dominant culture, dormant culture
8. What attributes to the formation of subcultures?
   i. The existence of smaller groups with similar occupations, situations, experiences, and problems.
   ii. The culture prevailing in the lower hierarchical levels of the organization.
   iii. Elements like age, occupation, and skill sets among groups.
   iv. The team-orientation element of organization culture that stresses on employees working in teams.
   a. Only i and iii
   b. Only ii and iii
   c. Only ii and iv
   d. Only iv
   e. Only iii
9. What is the factor that affects both sharedness and intensity?
   a. Induction program
   b. Commitment
   c. Strict rules
   d. Organization reward system
   e. Dominant culture
10. Different members of an organization have varying degrees of commitment to the organization’s core values. What is this degree of commitment known as?
    a. Sharedness of organizational culture
    b. Assumptions of culture
    c. Intensity of organizational culture
    d. Outcome orientation
    e. Organization reward system

3.7 Types of Culture

The classification of culture into four basic types is done by Quinn and McGrath based on interactions between individuals and groups in an organization. These types of culture are market culture, adhocracy, clan culture, and hierarchical culture.

Market culture

Market culture is an achievement-oriented culture and stability in the organization is given importance. In this type of culture, the output generated by employees acts as the base to assess the performance of employees.

Adhocracy

This type of culture is growth oriented. Here, organizations try to create an informal work atmosphere allowing for more flexibility and adaptability at the workplace. In this type of culture, employees are evaluated by their commitment to the organization. Usually, these types of organizations are led by managers who are charismatic and creative and are risk-takers.

Clan culture

In this type of culture, employees are encouraged by the top management to participate in decision-making. Here, the performance of employees is assessed by the quality of relationships they maintain with other members of the organization.

Hierarchical culture

A hierarchical culture prevails in organizations where the traditional leadership style is followed. Hierarchical cultures are characterized by formal organizational processes and obedience to the norms of the organizational culture. Leaders have strict control over employees' behavior at work and judge the performance of the employees based on their adherence to the set norms and formal procedures of the organization.

Example: Starbucks Organizational Structure In A Nutshell

Starbucks used both vertical and horizontal structures in their matrix organizational structure. It was distinguished by several divisions and chains of command that overlap. Starbucks was a sizable and well-known café business with more than a hundred thousand locations throughout the globe. Starbucks was governed by a board of directors that meets in Seattle, Washington, where the corporation was based. The business was divided into regional jurisdictions in the US, each of which was led by a district manager who was in charge of a set of stores. A store manager and shift supervisor oversaw a team of employees at each location.

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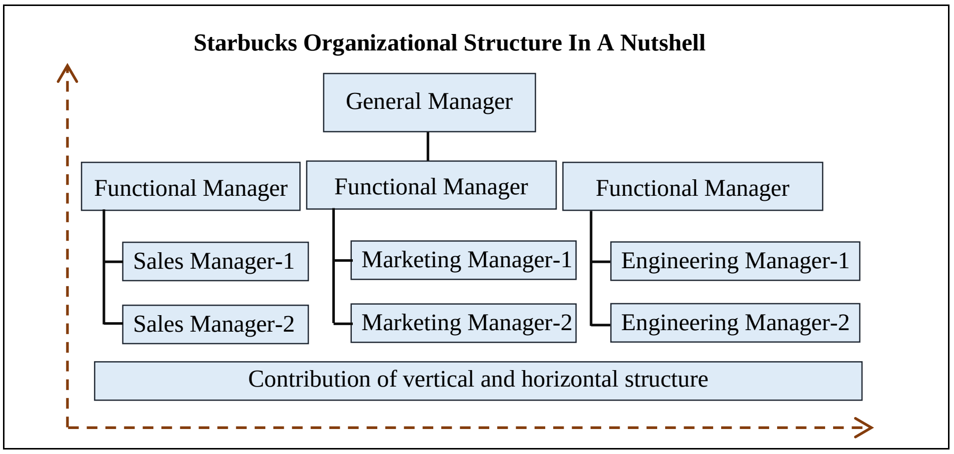

Source: Starbucks Organizational Structure In A Nutshell, https://fourweekmba.com/starbucks-organizational-structure/, March 29, 2021 | Accessed on 14 July 2022

3.8 Culture and Formalization

Culture and formalization are inter-related. The extent to which jobs in an organization are standardized can be termed as formalization. A highly formalized job is one that has to be done in a pre-determined manner, leaving little discretion to the employees involved, over even small elements of the job. Formalized jobs are, therefore, characterized by explicit job descriptions, clearly defined work processes and work flows, and a number of rules. On the contrary, less formalized jobs provide autonomy to employees and lead to diversity in job performance. Formalization in an organization should be done carefully by clearly documenting the rules and procedures to be followed by the employees. If a strong organizational culture exists, it could replace the process of formalization in the organization as both organizational culture and formalization aim to bring consistency in the behavior of employees in the organization. Formalization includes documentation of rules and procedures whereas organizational culture brings about consistency in the behavior of employees.

Example: Culture and Formalization at Southwest Airlines

Half-a-century ago, in 1967, Southwest Airlines (SWA) came into existence. At that time it didn't have stated values. However, it did begin with a common understanding of what kind of culture Southwest Airlines wanted to nurture. After ten years in operation, SWA had detailed policies and procedures for each task and process. The staff were required to conform to it in letter and spirit. The SWA leadership went beyond the physical workplace by establishing their six core corporate values: workers, customers, suppliers/vendors, low cost, and shareholders. They established a division called Culture Services with the goal of maintaining the emphasis on the company's core principles, which include "low cost" and its people.

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The firm prioritised its employees even though it recognised and celebrated everyone who contributed to its success. SWA periodically conducted a cultural drive called as "Culture Blitzes," in which a Culture Services team visited an airport and interacted with every Southwest employee and spent time sharing food and entertainment, and reminded employees of SWA's shared culture by cleaning the planes for the flight operations employees. Herb Kelleher, co-founder and chairman emeritus of the airline, aptly summed up the company's culture as, "The business of business is people".

Source: https://www.humansynergistics.com/blog/culture-university/details/culture-university/2022/06/24/southwest-airlines-reveals-5-culture-lessons, Jun 24, 2022 | Accessed on 2 November 2022

3.9 Functions of Culture

Organizational culture directs the behavior of employees. How the organization culture depicts some of its functions are discussed below.

The important functions of culture in an organization can be listed as follows:

- To create a boundary by defining role for employees
- To develop a sense of identity
- To encourage collective commitment
- To bring about stability of the social system
- To have a shared meaning of values, assumptions, norms, and control mechanism across an organization.

Example: Sense of cultural identity and Boundaries at Shell Petroleum Outlets

When Rakesh filled fuel at fuel stations other than Shell Petroleum, he always noticed the difference in the way the fuel was filled at Shell and the way they were done at other company outlets liked IOCL, HP etc. At Shell fuel station, a security guard stands outside the front of the fuel filling station waving the sign holder for customer to drive in and directs the customer to the specific fuel pumping station based on the service occupancy. Subsequently each and every person who was on the duty of fueling the vehicles wished the customer with a "Namaste" and ensures that the driver alights the vehicle and notices the "zero" on the meter before the fuel is released into the vehicle tank. They had written rules to this effect. Further, the employees of the outlet went an extra mile by advising the driver of the vehicle to wear the helmet / seat belt depending on the vehicle they drove. However, it was not the same with the other company outlets. Such behavior was displayed by the security guard in other stations only when there was a huge crowd or heavy traffic flowed to the filling station.

Source of inspiration: https://study.com/academy/lesson/functions-of-organizational-culture.html; © copyright 2003-2022, accessed on 2 November 2022. Taking the clue from the context, have developed this hypothetical situation which is an outcome of experiential lessons from daily life. The PDF document of the source content is also enclosed.

3.10 Beginning of Culture in an Organization

The founders of an organization influence the culture in the organization with their personal traits and values. Simply put, the founders of the organization lay the foundation for a particular culture in an organization. But once a culture has been adopted by the employees of the organization, it is difficult to bring in changes or modify it. Some of the factors which have an influence on maintaining the organizational culture are:

Selection

If the selection procedure of employees includes an evaluation of the adaptability of the candidate to the culture of the organization along with technical and professional evaluation, it would help the organization to select appropriate candidates who can more easily adopt the organizational culture. A strong organizational culture can be maintained when the new employees believe the values of the founders of the organization and adopt the culture existing in the organization.

Top management

The top management of an organization influences the culture in the organization to a great extent. Usually, the ideas and behavior of the top-level management seep down throughout the organization. Thus, the top management influences the employees regarding adopting the values of the organization.

Example: Things You can do to Bring Creativity into your Culture or Team

Pixar purposely embedded creativity into their culture and it drove their success. Instead of recruiting lonely geniuses, employers should seek for individuals who could collaborate well with others and who did not back down from a task. Daily animation work at Pixar was presented to the whole staff in an unfinished form. People became even more creative as a result of this process, which helped them get over any embarrassment about sharing incomplete work. In addition to employing talented individuals, Pixar had also demonstrated legendary levels of ingenuity in the way it created and managed its teams. If you wanted your company to be more innovative, you need to employ "growth mind-set" individuals and work with them to create a team dynamic and atmosphere that valued innovation, risk-taking, and meeting deadlines for product delivery to clients.

Source: https://www.forbes.com/sites/bernhardschroeder/2020/01/02/pixar-purposely-embeds-creativity-into-their-culture-and-it-drives-their-success--three-things-you-can-do-to-bring-creativity-into-your-culture-or-team/?sh=471cf585358a, Jan 2, 2020 | Accessed on 14 July 2022.

Socialization

The selection procedure in an organization cannot ensure getting an employee who perfectly fits the organization. However, the new employees can be guided to adopt the culture of the organization through the socialization process. Socialization is the formal procedure through which new employees to the organization are educated about the organizational culture, and encouraged to internalize the values and ideologies of the organization. Socialization is a three-stage process.

The three stages are:

- *Pre-arrival stage:* In this stage, employees are introduced to the norms, values, and procedures accepted in the organization. Each employee is treated as an individual who is distinct and with individually different principles and values.
- *Encounter stage:* This is a critical stage of socialization. In this stage, employees get to know about the reality of the workplace. If it coincides with the expectations of the employee, socialization can be effective. On the contrary, if the employees' expectations do not match those of the organization, it will have an adverse impact on the productivity of both the employee and the organization.
- *Metamorphosis stage:* This is the stage of socialization when employees mould their behavior according to the organizational expectations. A feeling of belonging develops, and the employee is less likely to leave the organization.

3.11 Learning Culture

The culture of an organization can be learned in different ways. Some ways of imbibing a culture is through stories, rituals and ceremonies, material symbols, and language as discussed below.

Stories

Stories relating to the behavior of employees in an organization help the new employees to easily analyze the expectations of the organization and its culture. Stories convey the ideologies of the organization's founders, the past experiences of employees in the organization, and what kind of behavior is considered acceptable in the organization.

Example: $2000 to Quit the Job - The Story of Charm that Lured Zappos Aspirants

Founded in 1999, Zappos was an American online shoe and clothing retailer based in Las Vegas, Nevada, united stated and later acquired by amazon in July 2009.

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As a part of the employee selection process, fifty percent of weightage was given to "culture fit interview". Later on, all employees irrespective of the hierarchy at which they were hired undergo a month long called center training. During the period all of them were imbibed with the 10 core values of the organization through various interactive learning tools. At the end of the first week of the training, the CEO of Zappos, Tony Hsieh (died in November 2020) used to offer a gift cheque of $2000 to quit Zappos if the employee found Zappos was not a place of their aspirations. This created wonders as this became the story of charm for all future career aspirants with Zappos.

Source: https://surveysparrow.com/blog/7-fabulous-organizational-culture-examples/ 27 August 2021 | Accessed on 2 November 2022.

Rituals and ceremonies

Rituals are activities that are repeated on particular occasions to help reinforce the core values and key objectives of the organization. The ceremonies in organizations mainly concentrate on appreciating exceptional performance. Understanding the rituals and ceremonies in the organization and their analysis helps in learning the culture of the organization.

Material symbols

Material symbols or rewards in an organization help in understanding the culture of the organization in recognizing employees at various levels of the organization. The culture of some organizations encourages equality among employees while others give importance to the status of employees in different positions in the organization.

Language

Employees in an organization may use particular technical terminology or acronyms or jargon, which are accepted by a majority while communicating with each other. Learning the common language of the organization helps a new employee to adapt to the organizational culture.

Activity 3.2

Zenith International has recruited a fresh batch of sales officers as part of its business expansion. The management of the organization wants the newly-recruited employees to learn the existing culture of the organization so that they can perform according to the set pattern of work. What are the different ways in which the new employees can learn the existing organizational culture? Discuss them in brief.

Answer:

3.12 Changing Organizational Culture

Usually change in an organizational culture may be initiated by a change in the external environment or a change at the top management level. In order to have a competitive edge, changes in the external environment should be anticipated in advance by organizations. The process of change in organizational culture is complex as the habits and set attitudes of employees cannot be changed so easily.

The change process

While changing organizational culture, the change process should be quick enough not to allow the employees to go back to their old patterns. A well-planned change process helps in avoiding uncertainty among employees. Some of the important things to be considered while implementing the change process are:

Assess existing culture: The existing culture in an organization should be assessed accurately and an analysis of the need for change should be done before bringing in change.

Change agent: It is always advisable to take the expert advice of an experienced external change agent, who guides the organization along the path of change. An external change agent can help in framing right change strategies by interacting with employees of the organization.

Introduce alternatives: If the change agent explains clearly to the employees about different alternatives for the existing practices in the organization and takes them into confidence, then the change process can be implemented effectively.

*Define a new paradigm***:** The change agent could define a new paradigm or model for organizational change and make employees aware about the need for change. This will help in reducing the anxiety of employees about the change in organizational culture.

Change must be top-down: The change in organizational culture will be more effective if it is initiated by the top-level management of the organization.

Employee participation: Encouraging employee participation in the change process will ensure that the decisions taken as part of the change process are accepted by the employees of the organization.

Shed old paradigm: The change agent should encourage the employees to adopt new procedures by leaving behind the old paradigm.

Quick transition: The transition in organizational culture should be accompanied by a quick decision-making process to bring about appropriate change.

Example: A Model for Culture Change

According to former Becton Dickinson CEO Vince Forlenza, "our culture—our lack of constructive conflict and engagement—was the obstacle that was most difficult to modify in order to establish a more inventive culture to meet the changing competitive landscape". The culture was changed by carrying out practical tasks in accordance with the new strategy, new governance model, business procedures, or performance management systems. Employees formed a task force and assigned to a particular function or business. They conducted interviews with team members in those functions, collaborated with employees from other functions and arrived at solutions. This collaborative culture proved to be very beneficial.

Source: https://hbswk.hbs.edu/item/to-change-your-companys-culture-dont-start-by-trying-to-change-the-culture, 14th December, 2021 | Accessed on 14 July 2022

Activity 3.3

Assume you are working as an HR manager for Atlas Technologies. Considering the changing external environment, the top management of the company has decided to bring in certain changes in the existing culture of the organization. Being the HR manager of the company, the task of bringing the required change in the organizational culture has been assigned to you. How would you guide the change process and ensure a smooth transition with the cooperation of employees?

Answer:

3.13 Organizational Culture and Management Controls

In the earlier topics, the concept of organizational culture and various related issues were discussed. If you see the organization culture and the controls within the organization, you see a strong connection among the control systems in the organization, control environment and organization culture.

In times of economic and financial crises when the organizations run into various financial problems, we often look at formal compliance procedures, incentive systems and other 'technical' ways to ensure effective internal control.

Organization(s) constitutes an element of a society and people bring different cultures from their own society into the organization. Organizations possess the paradoxical quality of being "part of" or "a part" of a society; which are embedded in a social context. Even though organizations are communities in their own right with distinctive rules and values, organizational culture, fosters success and it is therefore one of the most important factors that can account for success or failure of an organization.

The human resource of every organization is its backbone, such that the success or failure of any organization now depends on the workers. Organizations not only want to survive but also to grow and take over or even overtake existing competitors. This compels organizations to devise values, beliefs, behaviors, norms and strategies targeted at not just attracting, cultivating, and retaining their employees but also giving the organization a competitive edge.

It is now accepted that organizational culture has an important impact on the management practices.

Organization Culture as an Asset and Liability

Organizational culture might produce a conformist thinking inimical to creative organizational developments. Thus, when we talk about encouraging a strong culture, Robbins believes it should be looked into from the angle of the general effect it can have on an organisation.

We may note that the strong culture in the organization can become as asset to the organization or sometimes may become as a liability. If the core values of the organization are shared by all the employees across all the cadres it will influence the behavior of all the employees, then it becomes an asset to the organization. The degree of sharedness and intensity will create an internal climate of high behavioral control. If all the employees believe in what the organization stands for, the attrition of employees will come down and such unanimity of purpose builds cohesiveness, loyalty, and commitment. Strong culture in the organization will increase behavioral consistency. Strong culture replaces formalization of rules and regulations of the organization and facilitate what strong rule framework does such as predictability, orderliness, and consistency. The stronger culture reduces the burden of forming rules by the management.

The case of strong culture on the negative side becomes a liability and makes the organization dysfunctional.

For example, when shared values are not in agreement with employees the organizational effectiveness comes down drastically. This usually happens when an environment is undergoing rapid change and the entrenchment to culture might no longer be appropriate. Such consistency might only be an asset in a stable environment.

When strong culture starts putting pressure on employees and conformity becomes a problem, the range of values and styles accepted will be limited. This can conjure prejudice and undermine cooperate diversity, especially in a situation where there are new employees from different race, background, or any other differences, unlike most of the company members. This will effectively eliminate the unique qualities that people from different backgrounds could bring to the organisation. Here culture becomes insensitive to people who are different. And lastly, a strong culture will not encourage merger and acquisition of different companies. Companies merging historically is looked at as a financial advantage, but when the people from two organizations have the problem of cultural diffusion and agreement, then strong culture becomes a liability and therefore should not be encouraged.

Organization Culture, Internal Control, and Control Environment

Let us recap the constituents of the organization culture and the impact on internal controls.

Organization Culture: Let us see this Organization Culture from three aspects. Leadership, Ethics, Attitudes and Beliefs.

Organization culture is in a way defined by the leadership of the organization. The CEO of the firm is the torch-bearer of the organization culture. The set of important items of mission, vision and strategy communicated by the senior management is the binding force in the organization and lead the staff of the organization to the common goal. Any deviation from this goal, or conflicting views expressed by the management will adversely impact on the organization and create negativity in the organization culture.

Business ethics show in all aspects of the business conduct, from the board room strategies to the front desk personnel. It goes beyond legal requirements and shows whether business is conducted on values of integrity, honesty, and fairness.

It may be noted that if all the employees in letter and spirit follow the rules set by the organization, the set frame of organizational culture becomes strong. If there is dilution in following the code of conduct, it will have negative impact on the organizational culture.

In such a case, decisions are taken arbitrarily; organization lacks transparency and may disregard laws and regulations to achieve profitability. Commitment to follow the business ethics, reflect whether organization has high, medium, or low compliance risk. High compliance risk raises questions on reliability and authenticity of financial statements.

The organizational culture is reflection of the behavior and the psychology of the employees in day to day operations in the organization. Healthy trends in the organizations can be noticed if the employees are rewarded on their credible performance and there is no discrimination due to age, race, color and gender and there is no harassment of the employees whatsoever.

The strong organizational culture is a tool for management to control, motivate and enhance/improve employees' performance.

The organizational culture is a two-edged sword that can cut across both management and employees and therefore should be encouraged if it will lead to productivity and increase on performance, if not, other means of achieving performance should be employed.

Consequently, lack of these values, beliefs, and norms (organizational culture) could result in undesirable outcomes such as job dissatisfaction, lack of commitment, absenteeism, low productivity and labor turnover.

Culture is a great influencer on employees' motivation and behavioral pattern in an organisation that involves rooted shared values, beliefs, and assumptions. The culture of an organisation is the key that gives that organisation its shared sense of meaning. This sense of meaning is developed over a period in the forms of values, beliefs and actions that serve as a guide to employee's behavior.

The different societal beliefs, values and norms are carried into the organizations because organizations are subset of the larger society. Through working together as a group, the different cultural beliefs, values, and norms are fused together to develop behaviors, values, beliefs, habits, norms etc., which becomes peculiar to the organization. This forms the organizational culture of that organization.

Therefore, organizational culture covers all the core values, beliefs and shared assumptions that help to get employees committed and motivated.

Organizational culture is introduced to all employees once they are recruited, and this helps them to be acquainted with the organisation and the happenings in the system.

Internal Control: The COSO[3] defines *Internal Control* as "a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of the objectives in the following categories:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations

Example: Internal Controls at McDonalds - Transaction Processing, Made for you, Touch Interface Ordering and Hyperactive Bob System

When McDonald's placed an ordered with a supplier, the "transaction processing system" logs all pertinent data. This included the supplier's name, address, the caliber of the goods ordered, and eventually the invoice total.

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[3] COSO full form 'Committee of Sponsoring Organizations of the Treadway Commission'.

> The "made for you" system acted as a channel of communication between the counter crew and the kitchen team, enabling them to exchange information in real-time on the customer orders. Self-service ordering was made possible through the "touch interface ordering system", that accepted payments online. McDonald's management chose to used this approached to save labor expenses as much as possible. The "hyperactive bob system" had cameras that monitors the entrance and displays the parking lot load to the countered crew and kitchen staff. This enables them to assume the quantity of meal and products needed to meet the expected volume to the satisfaction of the customer.

Source https://www.studocu.com/ph/document/christ-the-king-college/bs-accountancy/information-system-used-in-mc-donald-internal-control/17283755, Academic year 2020/2021 | Accessed on 2nd November, 2022.

***Control Environment*:** The control environment is an organization’s culture, beliefs, and values. The environment includes the integrity, ethical beliefs and competencies of its people, which are visible in the management’s operating style, how management assigns authority and responsibility and how management organizes and develops its employees and what is the degree of involvement by the board of the directors of the organization in the day-to-day operations of the organization.

As defined in the earlier units, management control is dependent on many internal and external factors. This impacts the efficiency and effectiveness of the business operations of the organization.

An internal control auditor would benefit from the understanding and assessing the organization culture. An organization risk appetite, philosophy and exposures can be determined while analyzing the organization culture. A risk dashboard and/ or internal audit program should be developed keeping the organization culture in mind. An internal audit report must mention the impact of the organization culture on the internal control environment and the risks the organization is exposed to, due to negative or unhealthy organization culture. It is always important on the part of the organization to ensure that the recommendations provided by the internal auditors should be followed to improve and build a healthy organization culture.

The above mentioned three aspects clearly indicate that the organization culture has a significant impact on the control environment of the organization.

The management principles and practices will always influence organizational culture in order to enhance control effectiveness.

The way the leadership functions for the sustainability, their accountability at different major issues and other social control aspects within the organization will set pace for the strong connectivity to the organization culture and the management controls.

3.14 Summary

- Organizational culture is the general behavior of employees in a pattern guided by the accepted norms and procedures of the organization.
- The differences in backgrounds of the employees result in the existence of subcultures in the organization.
- Organizational culture can be strong or weak depending on the degree of sharedness and intensity of cultural aspects.
- Organizational culture is formalized to bring about uniformity in practices related to work.
- The top management of the organization influences the organizational culture to a large extent. The founder members' ideologies act as guidelines for the organizational culture.
- The culture of an organization is learned by its employees through stories, rituals and ceremonies, material symbols, and the language used by most of the employees in the organization.
- To bring about a change in the organizational culture, the top management should initiate the change supported by a dynamic decision-making process after thorough analysis of the existing culture and the need for change.
- There are strong connections among the control systems in the organization, control environment and the organization culture.

3.15 Glossary

Adhocracy: This structure is typically found in young organizations in highly technical fields. Within it, decision making is spread throughout the organization, power resides within the experts, horizontal and vertical specialization exists, and there is little formalization.

Change agent: People who act as catalysts and assume the responsibility for managing change activities.

Clan culture: In this type of culture, employees are encouraged by the top management to participate in decision-making.

Core values: The primary or dominant values that are accepted throughout the organization.

Hierarchical culture: Hierarchical cultures are characterized by formal organizational processes and obedience to the norms of the organizational culture.

Market culture: Market culture is an achievement-oriented culture and stability in the organization is given importance.

Rituals: Repetitive sequences of activities that express and reinforce the key values of the organization.

Socialization: The process that adapts employees to the organization's culture.

3.16 Self-Assessment Test

1. What is the organizational culture? How does it influence the employees of an organization?
2. How can a culture be learned? Also, discuss the different types of culture.

3.7 Suggested Readings / Reference Materials

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3.18 Answers to Check Your Progress Questions

1. (a) Ad hoc occurrences and actions with minimum acceptance

Organization culture is an evolutionary process where the processes shared across members of the organization get translated into a common practice and become a part of its culture.

2. (a) Only i, ii, and iii

Behavioral regularities indicate commonly used forms of interaction among employees in the organization.

3. (a) Rules

Organizations lay down strict guidelines for new employees to make them aware of how to get along in the organization and how to become accepted as members of the organization. These strict guidelines are called rules. All newcomers are expected to quickly learn the “ropes” in order to perform their assigned activities efficiently.

4. (b) Norms

Norms relate to the standards of behavior and guidelines on the quantum and quality of work that every employee in an organization must deliver. These standards of behavior must be adhered to in order to preserve the organizational culture.

5. (b) People orientation

People orientation refers to the degree to which the management takes into consideration, the effect of decisions made and the outcomes of these decisions on the people in the organization. Team orientation highlights the importance of employees working in teams and assessment of teams. Outcome orientation is concerned with end results as delivered by individuals.

6. (a) Dominant culture, subculture

The dominant culture represents the core values shared by most members in the organization. Organizational culture generally refers to its dominant culture. Subcultures, on the other hand, are values and norms which are held by a small minority of members in the organization. Subcultures are formed when people meet others with whom they can identify with and form various social categories or groups based on age, occupational or professional skills, union membership, etc.

7. (a) Subculture, large

Organization culture and dominant culture are generally the same. The extent to which values are shared varies and when limited to a small portion of an organization, it is called subculture. Subcultures are values and norms which are held by a small minority of members in the organization. Subcultures generally tend to develop in large organizations, where people belonging to similar occupational groups share common problems, situations, or experiences.

8. (a) Only i and iii

Subcultures are values and norms which are held by a small minority of members in the organization. Subcultures are formed when people meet others with whom they can identify with and form various social categories or groups based on age, occupational or professional skills, union membership, etc. Subcultures generally tend to develop in large organizations, where people belonging to similar occupational groups share common problems, situations, or experiences.

9. (d) Organization reward system

Sharedness and intensity are both influenced by the organizational reward system. Recognition and rewards motivate the employees and enhance their commitment towards the core values.

10. (c) Intensity of organizational culture

Different members of an organization have varying degrees of commitment to the organization’s core values. This is called intensity of organizational culture.

Unit 4

Strategic Performance Control

Structure

"Strategic management is not a box of tricks or a bundle of techniques. It is analytical thinking and commitment of resources to action. But quantification alone is not planning. Some of the most important issues in strategic management cannot be quantified at all."

- Peter Drucker, Austrian-American management consultant, educator, and author

4.1 Introduction

The performance of the organization has to take place within framework of controls designed by the organization. In this unit, let us study about Strategic Performance Control, which focuses on the relationship between strategy and control.

In the previous unit, we have discussed design of organization structure, and its importance in control systems. In this unit, we shall discuss the concept of strategic performance control.

Vision, mission, and strategy provide a fundamental direction for the organization to grow and expand. They help in guiding the organization toward optimum resource utilization and in directing the management's efforts. Organizational growth and the maximization of resource utilization need to take place within framework of management controls.

This unit will first discuss the relationship between strategy and control. Then we shall move on to discuss the importance of information technology and systems for strategic control. Finally, we shall discuss the balanced scorecard framework.

4.2 Objectives

After studying this unit, you should be able to:

- Discuss the relationship between strategy and control considering critical success factors, performance indicators and key result indicators.
- Recognize the importance of information technology and systems as a strategic performance control.
- Explain the Balanced Scorecard framework from different perspectives like customer, financial, internal business process, innovation / learning and growth perspectives.
- Gain awareness on implementation of 'Balanced Scorecard Framework'.

4.3 Strategy and Control

It becomes difficult for an organization to survive in the marketplace if the business environment is characterized by significant changes, like changing competitor moves, changing customer value-price perceptions, changing technology conditions, changing competitor profiles, and changing supplier equations. An organization that fails to quickly and appropriately respond to these changes would lose its competitive position. Organizations need to quickly learn from the changes and adapt to the changed variables. This becomes possible when there exists a strategic learning and an effective management control system.

Please refer Exhibit 4.1 for the story of BlackBerry in 2017.

Exhibit 4.1: Innovator's Dilemma – Where is BlackBerry

According to Gartner, which recently published its Q4 2016 smartphone rankings Out of 432 million devices shipped in Q4 2016, just 207,900 of them were BlackBerry OS products. The data shows that BlackBerry's global market share of 0.19% was significantly low, much below Windows Phone. During 2008 BlackBerry the company commanded almost 25% of the global smartphone market, a higher share than any company other than Nokia. The firm was expanding its businesses in other countries and it had ridden a wave of success to become the company most people thought of when they thought about business smartphones. In 2016 Blackberry's hardware business is in ruins, with a global market share of 0.0%.

The company's earnings calls further support the idea that its smartphone hardware is effectively dead, regardless of whether it runs Android or BB10. In its Q2 FY 2017 call, the question of Android security relative to BB10 was briefly discussed, with one analyst noting that BlackBerry's "highly regulated" customers didn't see Android as an acceptable substitute for BB10.

Contd….

In Q3 FY 2017 not one analyst asked about BlackBerry’s hardware sales or pivot towards Android. No information was provided in Q2 or Q3 about smartphone shipments, but the declining revenue and lack of investor interest prove the point. BlackBerry may release a few more branded handsets, but its smartphone business is dead.

The company’s fall from grace is an excellent example of what’s sometimes called the Innovator’s Dilemma. A well-established company with a dominant business model fails to anticipate the potential for new technology or services to upend its entire market. Blockbuster’s failure to adapt to Netflix is one example, and BlackBerry’s failure to respond to Apple and the rise of Android was another. BlackBerry was focused on growing its international market and believed business customers would prefer devices with physical keyboards, security features, and minimum bandwidth requirements to deliver services like email. But as 4G and LTE networks began rolling out, consumers started turning to devices that offered multimedia and convenience features that BlackBerry didn’t — notably, capacitive touch screens and more advanced third-party apps. At the same time, corporations began turning to Bring Your Own Device (BYOD) policies rather than strictly limiting which work phones people could use.

By the time BlackBerry realized it was hemorrhaging market share and users, it was too late to right the ship. Nothing the company did from 2010 – 2017 had even the slightest impact on its declining market share. The fact that analysts aren’t even asking about the product segments anymore is a clear sign that everyone expects them to vanish and sooner, rather than later.

Source: https://www.extremetech.com/mobile/244499-blackberrys-global-market-share-just-fell-0 By Joel Hruska on February 15, 2017

Strategic learning involves anticipating changes and monitoring the variables continuously, and countering them on a proactive basis. In a strategic learning context, management control aims at recognizing change and responding to it effectively.

Vision is an important guiding factor for an organization as it clearly explains what the organization intends to become in the future and reflects its core ideology. It lays down the direction path and controls the efforts made by the employees in the process. The mission statement is made based on the vision statement and states the reason for the organization's existence. The vision and mission statements together give directions for the organization to grow. These statements define the scope of business activities that the organization may undertake, thus controlling resource allocation and utilization. Please refer to the below example on Vision and Mission of LIC of India.

Example: Vision and Mission of LIC India

Vision

"A trans-nationally competitive financial conglomerate of significance to societies and Pride of India."

Mission

"Explore and enhance the quality of life of people through financial security by providing products and services of aspired attributes with competitive returns, and by rendering resources for economic development."

Source: <http://licindia.com/missian_visian.htm>

The strategies that an organization adopts control its strategic positioning, which translates into customer perception of the organization's products and services. The resources and strengths available with the organization and the strategic gaps existing in the marketplace play a key role in the choice of strategy that controls its performance. For example, Deccan Aviation effectively exploited the strategic gap for low-cost airlines. Similarly, with Dove, Hindustan Unilever exploited the strategic gap existing at the top end of the beauty soaps. Thus, the organization’s strategies directly control the organization’s performance. The degree to which strategies can control the organization's performance depends on the way it differentiates itself from its competitors and the ability of the competitors to respond to its strategies.

Example: Why Netflix Considers Losing a Million Subscribers a Success

Netflix, a leading OTT platform has lost one million subscribers. It was much less than their estimate of losing about two million subscribers by July 2022. However, to retain and increase the subscriber base, Netflix was planning to offer low cost subscription plans with an ad-supported version of all its current tiers (i.e., Basic, Standard, and Premium). For instance, Netflix has even created a special mobile tariff plan for India in 2019 that charged US$2.88 (INR 199) a month. Despite these low tariff plans, Netflix saw a 2% drop in average revenue per membership (ARM) in APAC countries and India. The poor business performance has forced Netflix to change its strategy and work on different approaches for Indian Market.

Source: Kamya Pandey, https://www.jumpstartmag.com/why-netflix-considers-losing-a-million-subscribers-a-success/ dated: 27th July 2022. (Accessed on 30.07.2022)

4.3.1 Critical Success Factors and Controls

According to John F. Rockart, critical success factors (CSFs) are the limited number of areas in which results, if they are satisfactory, will ensure successful competitive performance for the organization. They are the few key areas where things must go right for the business to flourish. These are the areas of activity that should receive constant and careful attention from management. CSFs, if ignored, will lead to eventual failure of the organization. The organization has to control its performance to address the needs placed on it by these factors. CSFs are monitored by the controls that are developed by the organization.

Each industry, and in turn, each organization has a different set of CSFs. CSFs differ depending on the mission and strategic goals of an organization. Strategic controls ensure that the mission is properly aligned with the strategic goals. All the CSFs are interrelated to each other and should be attended to by the organization in order to have a competitive advantage in the marketplace. For example, for a grocery retail chain, 'the ability to source farm fresh vegetables at low prices' and 'store location' could be two of the critical success factors. And in the case of a consumer electronics manufacturer, sustainable customer relationships with distributors and cutting edge research and development could be critical success factors.

CSFs, as a control function, indicate to the management the need to take timely action. Organizations should identify about five or six CSFs that would help them achieve their strategy, goals, and objectives. Once identified, the organization can depend on them to monitor business activities and be ready to face the changes in the business environment that could drastically affect the attainment of management goals. After deciding on the CSFs, the organization should track the activities that would help in achieving them and monitor their performance. Performance measures help in finding out whether the approach taken to address the CSFs is appropriate or not; achieving a more stable performance; and defining the employees' accountability.

4.3.2 Performance Measurement

Performance measures can be of three types -performance indicators, key performance indicators, and key result indicators.

Performance Indicators (PIs)

PIs reveal the organization's or the business unit's performance. There might be a variety of PIs in different areas. For instance, production PIs could be plant efficiency rates and machine downtime rates; HR PIs could be the attrition rates; etc.

PIs act as control tools by describing what is to be done, where to achieve the desired results or outcomes, and by identifying the specific areas that need control intervention to enhance organizational performance. PIs can be either lead indicators (performance drivers) or lag indicators (outcome indicators). PIs can be recognized by identifying the variable that is being measured and by understanding whether it is a single variable's performance that is being measured or the performance of collective variables in a single indicator.

The middle management may be interested in a PI that reflects a single variable's performance (e.g., machine downtime). However, the top management may be interested in a PI that indicates the collective performance of a number of variables in a single indicator (e.g., plant efficiency).

Good PIs are SMART, that is, Specific, Measurable, Attainable (Achievable), Realistic, and have a Time perspective. The frequency of monitoring PIs has shifted from periodic intervals (weekly or monthly) to a continuous or daily basis with the emergence of concepts like TQM and continuous improvement, and improvements in information systems and technology.

Key Performance Indicators (KPIs)

KPIs deal with aspects which when enhanced would result in radical performance improvements and would lead to a cascading improvement in most of the other PIs. They have an impact on all the key result areas of the organization. Better results from KPIs would result in better organizational performance. The top management uses KPIs as yardsticks or measures to monitor and control the organization's performance.

KPIs are identified from the PIs based on the strategic nature of the indicator considering the industry to which the organization belongs. Here, strategic nature refers to the indicator's ability to include performance measurement of multiple factors, both internal and external to the organization. Thus, KPIs for organizations will vary from industry to industry. KPIs also vary from organization to organization within an industry depending on the strategic positioning of the organization in terms of customer's (and other stakeholders') need fulfillment, that is, what is being satisfied, and how it is being satisfied. A KPI can be identified from a set of PIs based on how it reflects the performance parameters of several CSFs and based on how it reflects in totality the effect of other PIs.

Characteristics of Key Performance Indicators

Key Performance Indicators depict certain characteristics. The following are the details:

- KPIs are generally non-financial in nature. For example, in a dine-in restaurant, the occupancy level may be a KPI.
- These are usually measured at short intervals of time like 24 / 7, daily, or weekly.
- Top executives should devise KPIs in such a way that they are understood and effectively utilized by employees at all levels in the organization. Both teams and individuals are held responsible for the KPIs.
- KPIs have a major effect on most of the critical success factors and they have a positive impact on most of the PIs.

Please refer example for the Strategic Goals, Critical Success Factors and Key Performance Indicators of Musicana, a music retailing outlet in Mumbai.

Example: Critical Success Factors for a Music Company

Organization

Magic Music is a Music Retailing Outlet in Mumbai.

Mission

To become a leading music retailing outlet in Mumbai by selling the best quality, original CDs and DVDs to customers.

Strategic Goals

- To gain 30% market share in Mumbai.
- To collect a wide variety of music albums and provide best quality products. To gain and maintain 100% customer satisfaction.
- To expand product range in order to attract more customers.
- To have ample retail store space for the range of products that customers want.

Critical Success Factors

- To establish good relationship with leading and upcoming singers.
- To create successful long term relations with the wholesalers.
- To find out what the customer wants and procure it immediately if it is not available in the store.
- To attract and satisfy new customers. To get funds for expansion.

Key Performance Indicators

- Number of new customers gained and number of existing customers lost.
- Time taken to respond to a customer when requested for an unavailable product in the store.

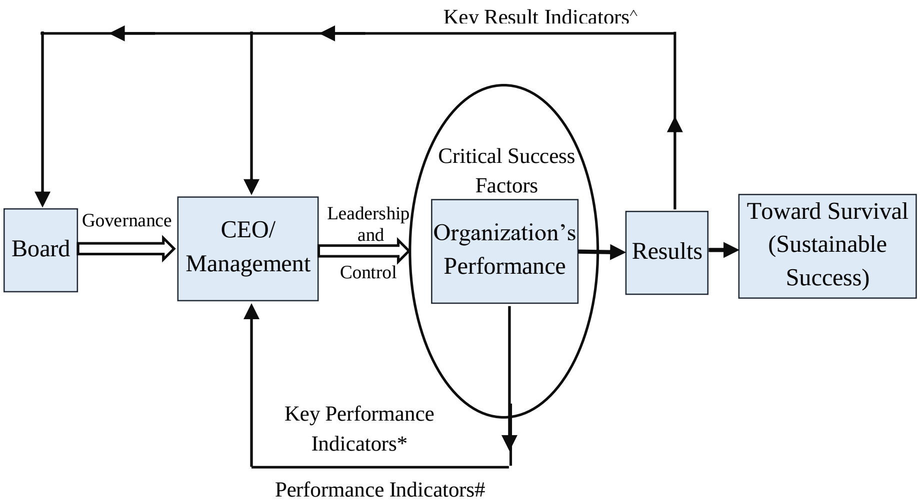
Source: ICFAI Research Center

Key Result Indicators (KRIs)

KRIs emerge from the organization's activities. They indicate whether the approach toward achieving performance is appropriate, but do not indicate a means or method to achieve better performance or outcomes. KRIs are indicators of the quality of the results achieved by the organization and are predominantly used for enforcing action accountability (after the action has been completed). These are measures that are useful for the governance aspect of the organization and are generally reported to the top management or the board, and are monitored on a monthly or quarterly basis. Return on capital employed and profitability are examples of key result indicators used by many organizations.

Figure 4.1 and example describe the relationship between the critical success factors and the different performance measures - performance indicators, key performance indicators, and key result indicators.

Figure 4.1: Critical Success Factors and Performance Measures



* Key Performance Indicators are usually monitored on a continuous basis [24 × 7].

Performance Indicators are usually monitored on a daily or weekly basis.

^ Key Result Indicators are usually reported to the board on a monthly or quarterly basis.

Source: ICFAI Research Center

Example: Critical Success Factors and Performance Measures – An Illustration

Let us consider the domestic passenger aviation market in India. A full-service airline in this market typically provides more services to passengers than a no-frills (low-cost) airline. Full-service airlines tend to attract business travelers and other frequent flyers who expect such services, along with guaranteed connectivity of flights, punctuality, etc. Under normal circumstances, full-service airlines charge a premium for the seats (even in the economy class) as compared to a no-frills airline. A suggested set of critical success factors, key performance indicators, performance indicators, and key result indicators are listed here for such a full-service airline. This list is only indicative and not exhaustive. It is assumed that the industry is highly regulated, and there are infrastructural constraints at the airports.

Contd….

Critical success factors

The following are critical success factors:

- Timely departure and arrival of aircraft
- Yield maximization
- Retaining frequent flyers and business travelers (through differentiated services, seamless travel experience)
- Retaining key employees
- Information systems
- Time slots of departure and arrival, and parking bays at the airport
- Regulatory clearances for operating in different sectors
- Compliance with safety norms and other regulations
- Seamless travel experience (alliances with hotels, tourism and transportation companies, portals, etc.)

Key performance indicators

The key performance indicators are as given below:

- Passenger load factor / seat occupancy per flight
- On-time Flight Performance Index (Number of flights that departed or are scheduled to depart more than one hour behind planned schedule)
- Number of incidents affecting safety or security per day (includes lost bags per 1000 passengers)
- Complaints per 1000 empanelment
- Performance indicators
- Available seat miles per employee
- Training hours per employee per month
- Promotion expense / ticket sales
- Number of flying hours per aircraft per month
- Number of preventive maintenance checks conducted on schedule
- Expected advertisement revenue for next issue of in-flight magazine
- Tickets booked per in-bound call center employee
- Percentage of tickets booked online (through airline website)
- Repeat booking / customer loyalty index / customer referral index

Contd….

- Average duration between consecutive travels of frequent flyers
- Revenue per transaction for frequent flyers
- Key result indicators
- Net profit before tax
- Customer satisfaction index
- Return on Capital Employed (ROCE)
- Debt-service coverage ratio
- Average service period of existing key employees
- Safety measures (incidents, renewal of licences)

Source: ICFAI Research Center

4.4 Information Technology and Systems for Strategic Control

Information technology and systems (IT&S) facilitate the continuous monitoring / reporting of various performance measures. Strategic information systems are information systems applications that serve the top management's needs for strategic performance control. In this section, we will discuss the areas where IT&S play a strategic role in the management control.

Deregulation and liberalization of economies has led to the emergence of the global organization. Present day organizations carry out manufacturing in various parts of the world to avail of cost-related and geographical advantages. They have also entered other countries to expand their market. This has called for fast and high quality of information flows, to effectively control the extensive and diverse activities of organizations. Investment in IT&S is seen as mandatory to achieve control of operations in many situations. The various contexts in which IT&S are of strategic significance are discussed in the next section.

Example: Integrated Command and Control Center: Smart Cities Mission

Ministry of Housing and Urban Affairs, Government of India has announced that all 100 smart cities will have Integrated Command and Control Centers (ICCCs) setup by the year 2022, under Smart Cities Mission (SCM). Each ICCC serves as the “nerve centre” for operations management in the city with day-to-day exception handling and disaster management. ICCCs have provided smart solutions to the city's municipal corporation and helped manage safety of Citizens and City surveillance.

Contd….

These centres have equipped with video walls for real-time monitoring, and integrated with emergency response system. Further these Centres carryout a better operations planning to include critical activities and also 24x7 manual maintenance.

These centres also provided valuable insights by processing complex data sets collected at Originating Points and aggregated to derive intelligence for an improved Operations planning and policymaking for future jobs. The integrated services from both ICCCs and CCTNS (Crime and Criminal Tracking Networks and Systems) network under the Ministry of Home Affairs has been useful to provide actionable information and facilitate decision-makers with an appropriate visualization.

Source: https://www.drishtiias.com/daily-updates/daily-news-analysis/integrated-command-and-control-center-smart-cities-mission, dated: 22nd April 2022. (Accessed on 29.07.2022)

4.4.1 Nature of Operations and Information Intensity

If the nature of operations is mechanistic and repetitive in nature (say, a printing press), IT&S are used to control the error rates and costs through Computer Numeric Control (CNC) machines and reduce reliance on human resources. In process industries (say, in dairy processing), IT&S enables automation and electronic links to schedule and control the workflow. In information-intensive industries (such as hotels and airlines), organizations use IT&S extensively to control their operations. For instance, in courier companies, IT&S controls the scheduling and routing of shipments. It also provides advanced tools to customers to track their shipment at any point of time.

An organization that uses IT&S to control quality and costs related to a business process in a better way can gain a competitive advantage over the others.

Strategic decision making involves a lot of uncertain and fuzzy variables. Techniques like the What-if Analysis and Decision Support Systems (DSS) help in controlling the inherent risks in decision making in such a scenario. For instance, entry into a new country to expand operations depends on political, economic, social, and cultural variables that are diverse in nature and also uncertain. A DSS can be used to develop a range of outcome alternatives from very positive to very adverse for each country that is being considered for entry.

4.4.2 Extent of Geographical and Operations Spread

IT&S plays a crucial role in controlling the diverse operations of an organization if they are geographically widespread, and / or cut across multiple industries, or the nature of industry is such that it requires global sourcing to be successful. IT&S plays a crucial role in ensuring uniform global quality standards in industries which require global sourcing and in which, the goods are marketed globally. Please refer Exhibit 4.2 below for Facebook's case in this context.

Exhibit 4.2: Facebook's Three-Pronged Approach to Enlarge its Market

With over three billion people having access to the Internet, Facebook, the online social networking service, yearns to yield yet three billion more people to come online in the next five years, largely from emerging markets like India and Africa. Since 2013, the company had shifted its focus on finding new ways to tailor its ad product to work compatible with feature phones and slower connections.

In 2015, Facebook rolled out a new kind of ad format, to bring a new video experiences, to low-bandwidth emerging markets. Paying extremely careful attention to make sure that it improves its product in emerging markets. Here are some of the adopted ways of Facebook that had pushed monetization for its users in emerging markets:

- Launched a Creative Accelerator program, to help advertisers think of unique ways to connect with regional audiences and work with the local infrastructure.

For example:

- In India, Facebook has created a "missed call" ad product where people can avoid using their data plan by having the advertiser pay the data costs of sending them some sort of content, like music or a celebrity message.
- It opened a sales office in Johannesburg to help it expand its reach in Africa.
- It constantly adjusted its ad products to make them better, like allowing advertisers to target users, based on their connections, or with the introduction of slideshow ads which create a video-like experience for low bandwidth.
- Launched an in-house initiative program called 2G Tuesdays, that prompted all of its employees to opt a one hour of a simulated slow connection once a week, to help them identify the ways to make the user experience even better.
- Partnered with non-profit organizations like Internet.org, which it leads and other local service providers for a service called Free Basics, which lets people use Facebook and other apps without paying.
- Facebook ensured that a steady stream of new people come online, who hopes to join Facebook and start bringing its ad revenue. While nearly 60% of its daily active users live outside North America and Europe, this accounted only for about a quarter of Facebook's total revenues. Hence, this initiated the company to shift its focus to respective percentages, by constantly improvising its ad experience in other parts of the world.

Source: www.businessinsider.in › Tech (2015)

4.4.3 Nature of Industry

IT&S plays a vital role in organizations that belong to industries such as automobiles and pharmaceuticals, which are significantly research-based, and those in which research activity is geographically widespread. It helps the organization to control both the overall research direction and the day-to-day research activities.

IT&S also plays a crucial role in industries in which organizations work together with vendors to enhance the product design of the inputs or where Just-in-Time inventory control is used as a standard practice. In such cases, collaborations with the vendors in product design should be controlled to ensure that the modified inputs are in tune with the production process.

Activity 4.1

Jai Logistics Company (JLC) was a decade old organization providing logistics services to various individuals and businesses in South East Asia. Its USP is that it delivers cargo to any destination within (a maximum of) two days. However, it does not have a good system in place to track the cargo from time-to-time during the transit period. Also, due to some ongoing transportation problems, the company has exceeded its proposed delivery time to some customers. A combination of these factors has led to the shifting of some old-time customers over to competitors. In your opinion, what is the significance of IT&S in such a situation and how would its introduction contribute to the improvement of JLC's performance?

Answer:

Check Your Progress - 1

1. An organization aims at leveraging on its resources or strengths and aligning them with the environment in which it operates by addressing its critical success factors. What are the critical success factors (CSFs) here?
   a. The organization cannot ignore and it has to control its performance to address the needs placed on it by them
   b. Reflect an organization's core ideology and control the effort direction of the employees

c. Reflect the performance of the organization or organizational unit
d. Deal with the aspects which when improved upon
e. Can be ignored by an organization in terms of priority.

2. Key performance indicators are one of the three types of performance measures. Identify upon what of the organization, such indicators will vary.
   a. Key result indicators
   b. Strategic positioning
   c. Governance
   d. Organization structure and culture
   e. Principle location
3. FineDine, a middle-tier restaurant chain, has identified the following CSFs: the acceptability of the menu offerings, location effectiveness, ambience acceptability, and the quality of dining experience. Which key performance indicator (KPI) would probably reflect the restaurant's ability to address these CSFs effectively and guide the decision on whether to open more outlets in the same city?
   a. Number of repeat customers at the restaurant
   b. Net profit before tax
   c. Occupancy level at the restaurant
   d. Customer satisfaction index
   e. Net profit after tax
4. As a control tool, performance indicators describe what is to be done, where to achieve the desired results or outcomes. Among these indicators, what are the performance drivers and the outcome indicators?
   a. Lead indicators and lag indicators
   b. Lag indicators and indicators
   c. Key indicators and lag indicators
   d. Results indicators and lead indicators
   e. Lead indicators and key indicators
5. What are those information systems applications that serve the top management's needs for strategic performance control?
   a. Strategic information systems
   b. Decision support systems
   c. What-if analysis
   d. Computer numeric controls
   e. Lag indicators

4.5 The Balanced Scorecard

One of the strategic control tools is Balanced Score Card. The Balanced Scorecard (BSC) is a management control system that enables an organization to clarify its vision and strategy, and convert them into action. It provides feedback on both the internal business processes and external outcomes to continuously improve the strategic performance and results. When fully deployed, the balanced scorecard transforms strategic planning from an academic exercise into the nerve center of an enterprise.

Organizations should combine both financial as well as non-financial measures to gain a complete picture of their overall performance. The Balanced Scorecard (BSC) is a concept that has gained importance in the evaluation of the overall organizational performance through a combination of financial and non-financial metrics / measures.

The BSC, proposed by Robert Kaplan and David Norton in 1992, helps organizations in strategic performance control by considering financial and non-financial measures; short-term and long-term goals; the organization's market performance and internal improvements; past outputs and ongoing requirements; etc. It also helps the organization in strategic learning.

The BSC framework considers four perspectives - customer, internal business, innovation / learning and growth, and financial - which are observed and evaluated in a combined manner. For instance, apart from the net profit margin, factors like new products, quality of product and / or service, and quality of customer service provided, give a clear picture of the organization's performance. Refer to Table 4.1 for the underlying questions corresponding to each perspective of the BSC framework.

Table 4.1: BSC Perspectives and the Underlying Questions

Perspective	Underlying Question
Customer perspective	To achieve our vision, how should we appear to our customers?
Financial perspective	To succeed financially, how should we appear to our shareholders?
Internal business process perspective	To satisfy our customers and shareholders, at what business processes must we excel?
Innovation/learning and growth perspective	To achieve our vision, how will we sustain our ability to change and improve?

Adapted fram Kaplan, Robert S. and David P. Nartan. The Balanced Scarecard - Translating Strategy into Action.Boston Harvard Business Schaal Press, 1996, p9.

Example: How Tata Motors applies Balanced Scorecard for Performance Measurement

Performance measurement, analysis and review are the critical steps in an organisation's progress towards its goals and vision. Tata Motors applied the balanced scorecard for tracking progress on the company's long term strategic objectives. Added to this, the company's NRC (Nomination and Remuneration Committee) also used the balanced scorecard to review and recommend to the Board, changes in the managerial remuneration such as the increment in the basic salary of the CEO or the MD. This review was done by including parameters such as the performance of the company as well as the individual whose remuneration was proposed to be reviewed. The balanced scorecard used quantitative measures including volumes, market share, cash flows etc.

Source: https://www.tatamotors.com/wp-content/uploads/2022/06/annual-report-2021-22.pdf, Annual Report 2021-22 (Accessed on 29.07.2022)

4.5.1 Customer Perspective

The customer perspective in BSC is concerned with attracting, satisfying, and retaining profitable customers / consumers in the chosen target segments. Attaining these objectives would enable the organization gain the targeted market share in terms of volume and / or value. Following four factors influence the customers' perception of the value delivered by an organization's product or service.

- **Quality:** Enhanced quality would reduce the defects that the products have, which in turn, creates a better image of the organization in the minds of the customers.
- **Time:** Taking less time to respond to customers' requirements consistently is considered critical in acquiring and retaining customers' loyalty.
- **Performance and service:** This aspect helps in determining the value addition that a customer gets on using the product / service.
- **Cost:** This factor deals with reducing the costs of orders, delivery, etc.

4.5.2 Financial Perspective

The financial perspective looks at the financial health of the organization. It is concerned with the increase in revenue, productivity, and profitability; reduction in costs; and better utilization of the organization's assets in monetary terms. Shareholders get the necessary information about the health of the organization when they look at the measures under the financial perspective. Sales turnover, earnings per share, and net profits are some of the financial indicators of the organization's performance. As financial results at a point of time are the outcomes of performance on the other perspectives at an earlier point of time, measures of financial performance are termed as 'lagging indicators'.

4.5.3 Internal Business Process Perspective

The internal business process perspective deals with the processes, decisions, and actions that influence customer satisfaction, and are internal to the organization. Cycle time, quality, and employee skills are some of the internal factors, which are broken down to the individual employee level. Every employee is given a specified target in terms of quality, cost, time, and service, which when reached, leads to the achievement of the corporate objective. This helps in creating a greater sense of accountability among the employees. Besides, it ensures that the employee targets or goals are aligned with the broad corporate objectives of bringing out improved products, improving the internal and external processes and after-sales service for the customers.

4.5.4 Innovation / Learning and Growth Perspective

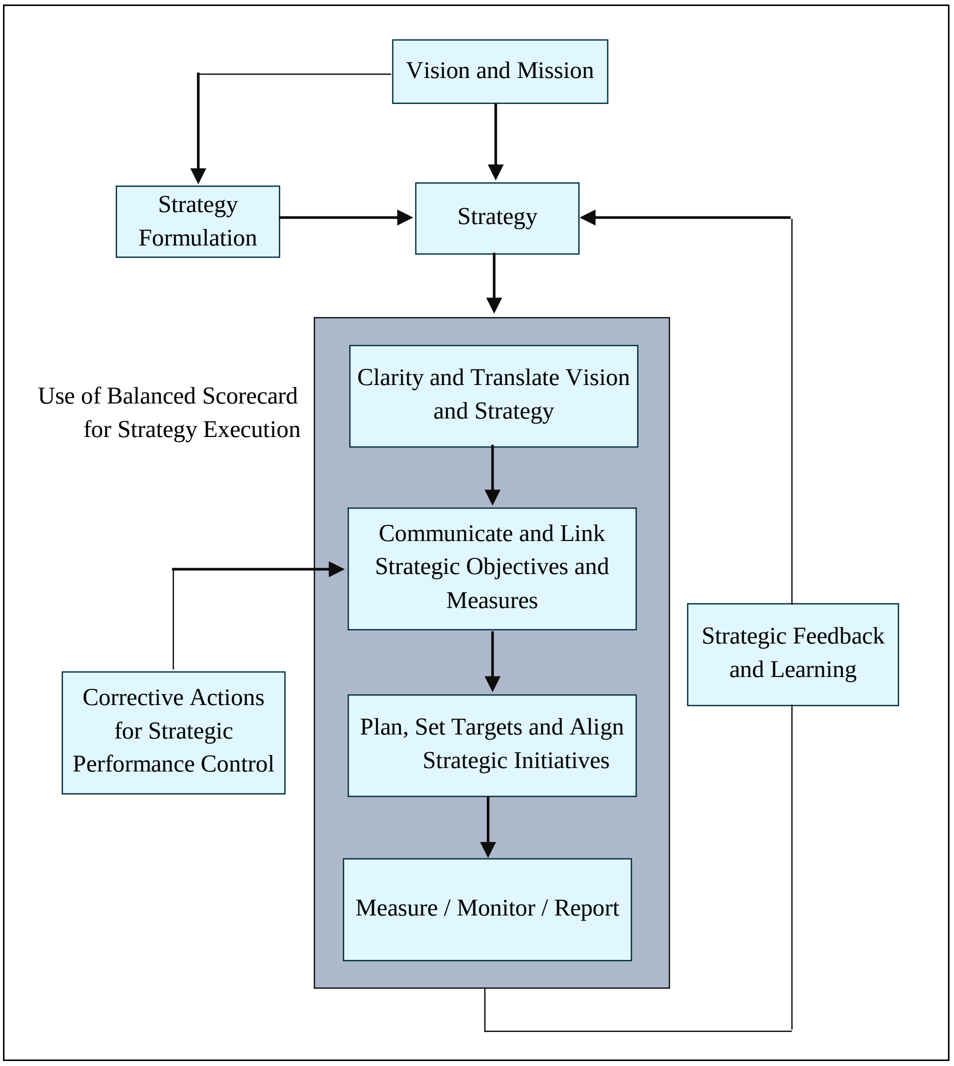
Organizations should regularly improve their existing products and processes. They should also come out with new products. This strategy helps the organization to manage business in a changing environment. The ability to come out with new products, enhance and upgrade the existing processes, and enhance employee capabilities depends on the organization's value systems. The shareholder value increases only when the organization grows by capturing newer markets, developing new products, improving operations, and enhancing the customer value proposition.

4.5.5 Implementing the BSC

BSC helps the organization in strategic performance control and strategic learning. An organization that lays stress only on short-term or financial goals cannot successfully carry out its strategies and excel in business. It clarifies the organization's vision and strategy, and expresses the expectations of the top management through clearly defined strategic objectives and related performance measures. These strategic objectives and measures are communicated throughout the organization in order to align the objectives of the organization with those of the individuals. They are also expressed in terms of more detailed, operational objectives at the department level, group level, or individual level. Once the individual and organizational objectives have been aligned, a business plan is devised. This plan helps the organization create a link between the short-term goals, long-term objectives, and the financials. The top management continuously monitors performance to assess whether the planned strategies are being successfully executed and to learn whether there should be a change in the strategy itself. Please refer to Figure 4.2 for appreciating the use of BSC as a tool for strategic performance control and strategic learning.

Figure 4.2 depicts the use of BSC as a tool for strategic performance control and strategic learning.

Figure 4.2: BSC as a Tool for Strategic Performance Control and Strategic Learning



Adapted from Kaplan, Robert S. and David P. Norton. The Balanced Scorecard – Translating Strategy into Action. Boston: Harvard Business School Press, 1996, p11.

Please refer to example for understanding how Tesco, a US-based retailer adopted the Balance Scorecard.

Example: Tesco's Steering Wheel

Tesco, a US-based retailer, adopted the Balanced Scorecard approach to meet its own requirements and re-named it as the Steering Wheel. The Tesco's Steering Wheel is divided into four quadrants - customer, operations, people, and finance. Each of these quadrants are divided into many segments. Further, each segment has a set of KPIs that are based on targets to be achieved by that segment.

Contd….

Customer	Operations
• Earn lifetime loyalty • The aisles are clear • I can get what I want • The prices are good • I don't want to queue • The staff are great	Shopping is better for customers Work is simpler for staff The way we operate is cheaper for Tesco The way we operate is responsible and safe
People	**Finance**
We trust and respect each other • My manager supports me to do good job • My job is interesting • I have an opportunity to get on	Grow sale Maximize profit Manage our investment

Source: <http://www.tesca.cam/csr/c/c2.html>.

Activity 4.2

Fresh Bakes, a start-up venture in confectioneries, had shown a dynamic increase in sales and growth in profits in early stages of its inception from June 2016. What would be the key performance controls of a confectionery industry? How would you assist Fresh Bakes to retain and expand its customer base in the chosen market, both in financial and non-financial terms using balanced scorecard, as a tool for measurement.

Answer:

Check Your Progress - 2

6. The Balanced Scorecard (BSC) helps the organization in its strategic learning process. Which of the following is not a perspective/ perspectives under which the BSC measures the performance of the organization?
   i. Financial perspective
   ii. Customer perspective

iii. Service perspective

iv. Learning and growth perspective

v. Internal business processes perspective

a. Only i and ii

b. Only iii

c. Only iv

d. Only i

e. Only iv and v

7. Which of the given four perspectives of the Balanced Scorecard (BSC) talks about past performances of the organization and hence, has 'lagging indicator' measures?

   a. Financial perspective

   b. Customer perspective

   c. Internal business process perspective

   d. Innovation and learning perspective

   e. Service perspective

8. The customer perspective of the Balanced Scorecard talks about how an organization wants itself and its products to be perceived by customers. According to the proponents of the BSC, which of the following is not a factor on which the customer's perception about an organization is built?

   a. Quality

   b. Time

   c. Earning

   d. Cost

   e. Performance

9. Identify the correct sequence of steps in the implementation of the BSC in an organization.

   i. Communicating and linking strategic objectives and measures

   ii. Business planning

   iii. Clarifying and translating the vision and strategy

   iv. Measuring, monitoring, and reporting

   a. i-ii-iii-iv

   b. i-iii-ii-iv

   c. iii-i-ii-iv

   d. ii-iii-i-iv

   e. i-iii-iv-ii

10. What is facilitated by the implementation of the Balanced Scorecard in an organization?
    a. Only strategic performance control
    b. Only strategic feedback and learning
    c. Both strategic performance control and strategic learning
    d. Only lead and lag indicators
    e. Both performance and key performance indicators

4.6 Summary

- Strategic learning involves anticipating changes and monitoring the variables mentioned continuously and countering them on a proactive basis.
- In a strategic learning context, management control aims at recognizing change and responding to it effectively.
- Vision clearly explains what the organization intends to become in the future and reflects its core ideology. The mission statement is based on the vision statement and states the reason for the organization's existence.
- The vision and mission statements together define the scope of business activities that the organization may undertake, thus controlling resource allocation and utilization.
- The strategies implemented by the organization directly control its strategic positioning and performance.
- Critical success factors (CSFs) are the limited number of areas in which satisfactory results will ensure successful competitive performance for the organization. CSFs should receive constant and careful attention from the management.
- Performance measures can be of three types: performance indicators (PIs), key performance indicators (KPIs), and key result indicators (KRIs).
- PIs act as control tools by describing what is to be done, by describing where to achieve the desired results or outcomes, and by identifying the specific areas that need control intervention to enhance organizational performance.
- KPIs deal with aspects which when enhanced would result in radical performance improvements and would lead to a cascading improvement in most of the other PIs.
- KRIs indicate whether the approach toward achieving performance is appropriate but do not indicate a means or method to achieve better performance or outcomes.
- Nature of operations and information intensity, extent of geographical and operational spread, and nature of industry are some of the contexts in which IT&S are of strategic significance.

- Balanced Scorecard (BSC) helps the organization in strategic performance control and strategic learning.
- The BSC framework considers four perspectives - customer, financial, internal business process, and innovation/learning and growth - which are all observed and evaluated in a combined manner.
- The customer perspective is concerned with attracting, satisfying, and retaining profitable customers / consumers in the chosen target segments.
- The financial perspective is concerned with increase in revenue, productivity, and profitability; reduction in costs; and better utilization of the organization's assets in monetary terms.
- The internal business process perspective deals with the processes, decisions, and actions that are internal to the organization that influence customer satisfaction.
- The innovation / learning and growth perspective help the organization to manage business in a changing environment by coming out with new products, enhancing and upgrading the existing processes, and enhancing employee capabilities depending on the value systems of the organization.
- BSC clarifies the organization's vision and strategy, and expresses the expectations of the top management through clearly defined strategic objectives and related performance measures. These strategic objectives and measures are communicated throughout the organization in order to align the objectives of the organization with those of the individuals. The top management continuously monitors the performance to assess whether the planned strategies are being successfully executed and to learn whether there should be a change in the strategy itself.

4.7 Glossary

Balanced Scorecard (BSC): BSC, proposed by Robert Kaplan and David Norton in 1992, is a concept that combines financial and non-financial measures, short-term and long-term goals, the organization's market performance and internal improvements, and past outputs and ongoing requirements. It helps an organization in strategic performance control and strategic learning.

Critical Success Factors (CSFs): CSFs can be defined as the limited number of areas in which results, if they are satisfactory, will ensure successful competitive performance for the organization. They are the few key areas where things must go right for the business to flourish. These are areas of activity that should receive constant and careful attention from management.

Information Technology and Systems (IT&S): A system that facilitates the continuous monitoring / reporting of various performance measures.

Internal Business Process Perspective: A perspective that deals with the processes, decisions, and actions that influence customer satisfaction, and are internal to the organization.

Key Performance Indicators (KPIs): KPIs deal with aspects which when improved upon lead to radical performance improvements. They have an impact on all the key result areas of the organization.

Key Result Indicators (KRIs): KRIs are indicators of the quality of the results achieved by the organization and are predominantly used for enforcing action accountability (after the action has been completed). These are measures that are useful for the governance aspect of the organization and are generally reported to the top management or the board and are monitored on a monthly or quarterly basis.

On-time Flight Performance Index: An index that specifies the number of flights that departed or are scheduled to depart more than one hour behind planned schedule.

Performance Indicators (PIs): Performance indicators reflect the performance of the organization or the organizational unit. An organization may have a variety of performance indicators in different areas.

Strategic Learning: Strategic learning involves anticipating changes, monitoring the business environment continuously, and taking proactive steps.

Strategic Information Systems: Information systems applications that will serve the top management's needs for strategic performance control.

4.8 Self-Assessment Test

1. Explain the following, with suitable examples.
    a. Critical success factors
    b. Performance indicators
    c. Key performance indicators
    d. Key result indicators
2. 'Strategic information systems serve the needs of the top management for strategic performance control.' Explain the statement. How can information technology and systems help in controlling the strategic performance of an organization?
3. Balanced Scorecard (BSC) is a technique that can be used to evaluate an organization's performance through a combination of financial and non-financial measures. Describe the BSC technique and the various perspectives used in the BSC framework. How does implementing BSC facilitate both strategic performance control and strategic learning?
4. Briefly explain the critical success factors and controls of an organization that persuades the need for competitive performance.

5. 'A mission and vision statement of a company paves the way for communicating to its stakeholders, the company's purpose of who we are, what we value and what we want to become.' In this context, narrate the significance and differences of vision and mission statement of an organization with example.
6. What are KPIs? State its characteristics.

4.9 Suggested Readings / Reference Material

1. Stephen P Robbins, David A. De Cenzo and Mary Coulter. *Fundamentals of Management: Essential Concepts and Applications*, Fifteenth Edition| By Pearson Paperback – 30 June 2022.
2. Subhash Chandra Das, Management Control Systems – Principles and Practices, PHI Learning Pvt. Limited, Paperback – 15 July 2019.
3. Pravin Durai, Principles of Management: Text and Cases, First edition, Pearson India Education Services Pvt. Ltd.; Second edition (31 August 2019)
4. Xianzhi Zhang, Enterprise Management Control Systems in China, First edition, Springer-Verlag Berlin Heidelberg, 23 Sep 2016.
5. Prof. Kenneth Merchant and Prof. Wim Van der Stede, Management Control Systems: Performance Measurement, Evaluation and Incentives, Third edition, Prentice Hall, 2011.

4.10 Answers to Check Your Progress Questions

1. (a) The organization cannot ignore and it has to control its performance to address the needs placed on it by them

Critical success factors (CSFs) are those which the organization cannot ignore. It has to control its performance to address the needs placed on it by them. The reason being, if the CSFs are ignored the organization will fail sooner or later. An organization's vision is its envisioned future and reflects its core ideology. It spells out clearly what the organization intends to become in the future. As such, it provides a direction path and controls the effort direction of the employees. Performance indicators reflect the performance of the organization or organizational unit. Key performance indicators deal with aspects which when improved upon lead to radical performance improvements. They have an impact on all the key result areas of the organization.

2. (b) Strategic positioning

Key performance indicators (KPIs) deal with aspects which when improved upon lead to radical performance improvements. The key performance indicators will vary from organization to organization depending on the strategic positioning of the organization.

3. (c) Occupancy level at the restaurant

Occupancy level is a yardstick Key Performance Indicators (KPI) which will reflect the acceptability of menu offerings, location effectiveness, ambience acceptability, and the quality of dining experience (which are Critical Success Factors (CSFs). The number of repeat customers is a performance indicator (PI) and not a KPI. Even if the number of repeat customers is high, it does not necessarily translate into high occupancy levels. Net profit before tax and customer satisfaction index, are examples of key result indicators.

4. (a) Lead indicators and lag indicators

Performance indicators can either be lead indicators or lag indicators. Lead indicators are the performance drivers while lag indicators are the outcome indicators.

5. (a) Strategic information systems

The continuous monitoring / reporting of various performance measures has been greatly facilitated by advancements in information technology and systems (IT&S). Strategic information systems are those information systems applications that serve the top management's needs for strategic performance control. Strategic decision-making may involve a lot of uncertain and fuzzy variables. Using techniques such as 'What-if Analysis' and Decision Support Systems.

(DSS) helps in controlling the inherent risks in decision-making in such a scenario. If the nature of operations is mechanical and repetitive, as in the case of the production process in a printing press, IT&S helps in controlling the rate of errors and cost control by introducing Computer Numeric Control (CNC) machines and reduces the reliance on human resources.

6. (b) Only iii

The four perspectives under which the BSC measures the performance of the organization are: financial perspective, customer perspective internal business processes perspective, and learning and growth perspective.

7. (a) Financial perspective

The financial perspective addresses the organization's financial health. As financial results at a point of time are the outcomes of performance on other perspectives at an earlier point of time, measures of financial performance are termed as lagging indicators.

8. (c) Earning

The four factors according to the customer perspective of the BSC are: quality, time, performance and service, and cost. Earning is one of the financial indicators of the organization's performance and does not necessarily influence a customer's perception of an organization.

9. (c) iii-i-ii-iv

Given the vision, mission, and strategy as inputs, the BSC serves as a tool for strategic performance control by clarifying the vision and strategy of the organization and articulating the top management's expectations in terms of clearly defined strategic objectives and associated measures of performance. To align the organization's objectives with individual objectives, these strategic objectives and measures are communicated throughout the organization, and also expressed in terms of more detailed, operational objectives at the departmental level, group level, or individual level. Once the individual and organizational objectives have been aligned, a business plan is devised. This helps the organization in creating a link between the short-term goals, long-term objectives, and the financials. The top management continuously monitors the performance.

10. (c) Both strategic performance control and strategic learning

Given the vision, mission, and strategy as inputs, the BSC implementation facilitates strategic performance control. The top management continuously monitors performance to assess whether the planned strategies are being executed successfully. In addition, the top management also learns from this process whether there should be a change in the strategy. That is, the BSC, as a tool, facilitates both strategic performance control and strategic learning.

Unit 5

Business Ethics and Management Control

Structure

"Ethics is knowing the difference between what you have a right to do and what is right to do."

- Potter Stewart, American Lawyer and Judge

5.1 Introduction

Ethics are the rules or standards that govern the conduct of employees in an organization. In this unit, you will learn how to ensure ethical behavior of the employees.

In the previous unit, we have discussed the concept of strategic performance control. The organizations have to perform within the legal framework of the land and the organizational rule book, which includes set ethos, ethics and values of the organizations in a formal or informal way. In this unit, we shall discuss business ethics, and its importance in management control.

The term ethics is derived from the Latin word 'ethicus' meaning manners or character. In an organizational set-up, ethics can be defined as the rules or standards governing the conduct of individuals and organizations. Ensuring ethical behavior among employees is a very complex problem that requires an in-depth understanding of many factors, which contribute to their decisions to behave ethically or otherwise. Organizations attempt to ensure that their employees behave ethically, using control systems.

This unit will first discuss the concept of ethical behavior in organizations. We shall then move on to discuss the management controls used and the ethical issues arising in the different organizational functions. Finally, we shall identify the different ways of regulating ethical conduct.

Example: Integrity is Critical in Everything we do

The Success story of GE starts with its people. It was a known fact that GE was committed and encourages their employees to fulfill their greatest potential. To build the best teams, GE regularly was investing in the development of their employees. It has ensured the sustainability of talent and improved skills to achieve an enhanced individual performance as well as company performance. For instance, GE Ethics & Compliance program was focused on factors such as prevention, detection, and response. Initially it was began with leadership's personal engagement on integrity. GE leaders drove a culture of integrity everywhere in GE by leading by example, incentivizing compliance, and promoting open reporting. GE working culture was supported by a robust Ethics & Compliance program and was evolving as new risks emerge. GE relied on a team of legal and functional experts to stay ahead of significant compliance risks and a changing regulatory landscape.

Source: 2022, https://www.ge.com/sustainability/ourculture accessed on 02/08/2022

5.2 Objectives

After studying this unit, you should be able to

- Discuss how difficult to survive in the market-place wherever there exists a significant change in the business environment. Know what should be the management strategy and control to overcome the same.
- Visualize how the Information Technology and Systems (IT&S) facilitate the continuous monitoring / reporting of various performance measures, as a part of strategic control.
- Explain the importance of Balanced Scorecard (BSC) from different perspectives like customer, financial, internal business process, innovation / learning and growth, and implementation of BSC.

5.3 Ethical Behaviour in Organizations

The ethical approach to handle a specific issue in the organization would benefit the organization but may not benefit the individual, while the unethical approach may benefit the individual but would harm the organization. It is the responsibility of supervisors to ensure that their subordinates act in an ethical manner. The ethical behavior of an employee depends on factors such as the individual's ethical philosophy and ethical decision ideology; other individual factors; organizational factors; and external environmental factors.

Example: IT Companies Worry about Moonlighting During WFH

Moonlighting was the practice of working on a second job outside normal business hours of the primary job. Most employers or private organizations have policies in place that prohibited this practice and take strict actions against the employees taking up a second job. For instance, Salesforce created a separate channel for Gig workers to ensure that their employees don’t abuse their office time. Salesforce created a hybrid workforce that included part-timers. Employees were also given a choice of working from home and put them in a place with different security controls and accommodated them in an existing organisation structure.

Source: Shipha Fadnis, https://timesofindia.indiatimes.com/business/india-business/it-companies-worry-about-moonlighting-during-wfh/articleshow/89392434.cms dated 8th February 2022 (Accessed on 30.07.2022)

5.3.1 Ethical Philosophy and Ethical Decision Ideology

The ethical system of an individual consists of his / her ethical philosophy and ethical decision ideology.

Ethical philosophy

An individual's ethical philosophy represents the collection of ethical principles that he / she holds. Under different situations in an organizational set-up, individuals may follow three different ethical philosophies - utilitarianism, individual rights, and justice.

- Utilitarianism recommends that a course of action that achieves 'the greatest good for the greatest number of people' is ethical.
- The individual rights philosophy deals with safeguarding the rights of individuals, such as the right to be informed, right to free speech, right to free consent, the right to privacy, and the right to due process.
- Justice requires that the rules of the organization should be enforced with fairness and impartiality, and suggests that individuals should be accountable only for factors which are under their control and not otherwise.

Ethical decision ideology

Ethical decision ideology is concerned with how different individuals apply their ethical philosophies for decision-making when faced with ethical dilemmas. Ethical decision ideologies can be classified based on two dimensions: idealism and relativism.

- Idealism refers to the belief that behaving ethically ensures positive results.
- Relativism refers to the belief that moral values depend on circumstances.

There are four classifications of ethical decision ideologies based on these two dimensions:

- **Absolutist:** It refers to a person who scores high on idealism and low on relativism. An absolutist believes in strictly following the universally accepted ethical principles.
- **Exceptionist:** It refers to a person with a low score on both idealism and relativism. Exceptionists refer to universally accepted ethical principles for broad guidance rather than for strict adherence. Exceptionists are open to making exceptions based on the situation.
- **Situationist:** It refers to a person who scores high on both idealism and relativism. A situationist takes a decision on a case-to-case basis by studying and comprehending the situation at hand. Situationists do not believe in the application of standard ethical principles, irrespective of whether these principles are accepted universally or at an individual level.
- **Subjectivist:** It refers to a person who scores low on idealism and high on relativism. Subjectivists prefer to abide by their respective individual ethical principles rather than adhering to universally accepted ethical principles.

Table 5.1 depicts the matrix of ethical decision ideologies.

Table 5.1: Ethical Decision Ideologies Matrix

Relativism	**Low**	**High**
Idealism	Low Subjectivist	Exceptionist
High	Absolutist	Situationist

Adapted from Stead, Edward W.; Dan L. Warrell and Jean Garner Stead, "An Integrative Model for Understanding and Managing Ethical Behavior in Business Organizations." Journal of Business Ethics. Val. 9 Issue 3, Mar1990, p233-242.

5.3.2 Individual Factors

An individual's value system is an important factor that determines whether he or she will behave ethically, or not, when faced with an ethical dilemma. Other individual factors, which influence ethical behavior include:

- Age of the person
- Ego strength - High, low
- His / her locus of control - Internal, external
- Level of moral development - Pre-conventional level, conventional level, post-conventional level.

The decisions taken by the individuals in the past form the decision history and influence his / her present and future decision-making. The ethical philosophy of the individual and the ethical decision ideology impact his / her decision history.

5.3.3 Organizational Factors

Several organizational factors directly influence the behavior of employees and the ethical decision-making process. These include:

Culture and structure

The culture of an organization includes the prevailing values, belief systems, and norms. The hierarchy of authority decides the level of autonomy or freedom (both the number and types of decisions taken and the extent of empowerment that the employees have) that the employee enjoys. This is an important factor that contributes to ethical behavior. Ethical decision-making can be encouraged by allowing the employees, whose activities ethically affect the organization, to choose activities which are ethical. Unethical behavior can be curbed by delegating decision-making rights to employees who are skilled enough and aware of the characteristics and outcomes of the decisions that are made.

Performance measurement systems

Performance measurement systems are used to assess the performance of employees against predetermined standards or targets. Systems which are too stringent may trigger unethical behavior. A performance measurement system should be designed to identify unethical behavior and to communicate to the employees that the management would not approve of unethical behavior. Further, employees empowered to make ethical decisions should be well informed about the consequences of unethical behavior. Performance measurement systems should be so designed that they do not require employees to resort to unethical means to achieve expected performance levels. Also, it should reward ethical behavior.

Reward systems

The reward systems in an organization, which may be both monetary and non-monetary, should incorporate clauses which enforce ethical behavior. Monetary rewards include incentives, bonuses, and Employee Stock Option Plans, while non- monetary rewards consist of memberships of resorts and clubs, all-expenses paid vacations, etc. Reward systems should be integrated with the performance measurement systems, and should reflect the extent of decision-making authority given to employees.

Position-related factors

Position-related factors that influence ethical behavior include peer pressure, expectations of the top management regarding achievement of objectives, presence or absence of a code of conduct, superior-subordinate relationships, and the extent of resource availability. Positions that have a central role would involve employees facing more situations where ethical dilemmas arise. Organizational factors also affect the decision history through reward systems. Employees will tend to behave ethically if that behavior is rewarded. Employee will refrain from unethical behavior if he / she is punished for that behavior.

5.3.4 External Environmental Factors

Environmental factors, here, refer to external environmental factors like greater competition in business, fluctuations in the economy, and the availability of resources, which influence the ethical behavior of employees. Political and economic factors, social factors, and the legal environment in which the organization operates are some of the environmental factors that influence ethical behavior.

Political and economic factors

Political and economic factors include government policies, tax structures, and the tariffs and duties levied on imports. To stay ahead of competition, many organizations resort to bribing government officials to get contracts or licences for businesses or to get the duties and tariffs reduced.

Social factors

Giving the right information to customers regarding the products being sold or new product being launched is one of the major ethical considerations that companies must keep in mind. Being ethical serves as a competitive advantage for organizations, as it builds a good reputation and image.

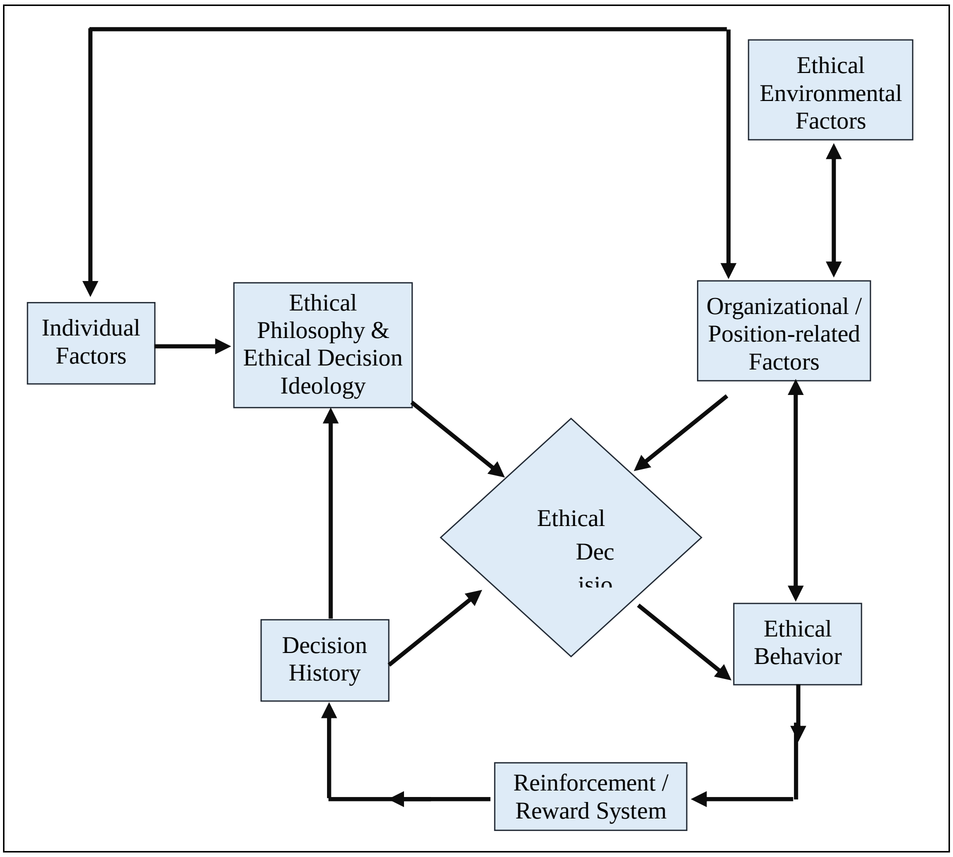
5.3.5 Integrated Framework for Ethical Behavior

Edward Stead, Dan L. Worrell, and Jean Garner Stead developed a conceptual framework to explain why employees behave ethically or unethically, and provided pointers as to how this behavior can be controlled by managers. It suggests that individual factors and organizational / position-related factors influence each other and also influence the way in which the individual's ethical philosophy and ethical decision ideology are formed. The organizational factors are in turn influenced by external environmental factors.

Ethical behavior of the employee results from the decisions that the employees take depending on their ethical philosophy and ethical decision ideology. The manifestation of ethical decisions as ethical behavior is also directly influenced by the organizational / position-related factors. When the ethical behavior of the individual is rewarded or punished, these decisions become a part of the decision history which further influences the decisions and behavior of the employees.

Figure 5.1 depicts this integrated framework of ethical decision-making and behavior of employees in an organization.

Figure 5.1: Ethical Decision-Making and Behavior of Employees



Adapted from Stead, Edward; Dan L. Warrell and Jean Garner Stead, "An Integrative Model for Understanding and Managing Ethical Behavior in Business Organizations." Journal of Business Ethics. Val. 9 Issue 3, Mar 1990, p233-242.

Activity 5.1

You are an engineer in a company that manufactures solvents for different industries. You have found that there is adulteration taking place, and inferior quality products are being supplied to clients. You report this finding to the manager, but he seems to be unconcerned. What will you do in such a situation?

Answer:

5.3.6 Controlling Ethical Behavior

Organizations should have mechanisms like a code of ethics, ethics committee, and ethics training in place so as to ensure that ethical behavior is ingrained in the employees. Ethical behavior can also be managed in an organization by selecting the right people through proper selection tests and by creating positions in the organization which deal specifically with ethical issues.

Check Your Progress - 1

1. What is the factor affecting the ethical behavior of an employee that may be classified based on two dimensions: idealism and relativism.
   a. Ethical philosophy
   b. Individual's value system
   c. Ethical decision ideology
   d. Ego strength
   e. Business ethics
2. Soham is an individual who believes that behaving ethically ensures positive results. He also believes that moral values cannot be affected by circumstances and that they remain unchanged in all situations. Based on these two characteristics, Soham may be said to follow a / an ethical decision ideology.
   a Exceptionist
   b. Situationist
   c. Subjectivist
   d. Absolutist
   e. Extremist
3. Which of the following is not the organizational factors that influence the behavior of the employees?
   a. Structure and culture
   b. Ego strength
   c. Performance measurement systems
   d. Reward systems
   e. Ethical behavior
4. The reward systems in an organization may be both monetary and non-monetary. What is an example of a monetary reward?
   a. Membership to clubs
   b. Kickbacks
   c. Employee stock option plans
   d. All expenses paid vacations
   e. Residential quarters for employees

5. Which of the following is not the external environmental factors affecting the behavior of the individuals in an organization?
   a. Political factors
   b. Legal environment
   c. Social environment
   d. Ethical system
   e. Economic factors

5.4 Management Control and Ethical Issues in Different Functions

While designing a control system, the manager should have a basic understanding of various relevant ethical issues. Ethics is an important tool for defining how employers should behave and is an important component of personnel control. If the ethical and moral standards of employees are high, then they can augment action controls. For example, if employees in an organization are not fraudulent, then the company can do with mild financial controls.

In the context of management control systems, design and their implementation, there are several ethical issues that may arise in different functions.

Example: Luckin Coffee Accounting Fraud

Luckin Coffee Inc. (Luckin) was a beverage retailer in China. Luckin fabricated business performance by way of an overstated revenue, coupon sales, and redemptions. Luckin's Management intentionally misrepresented the company and produced false accounting documents to mislead stakeholders for their own advantage. Ethics failure in Luckin's case included all levels of a company, including senior management, the board of directors, audit committee, internal auditors, and external auditors. Many failures were a result of conflicts of interest, dishonesty, misuse of power, and failure to perform fiduciary duties. Fraud was usually seen due to multiple parties' misconduct. However, management had the duty to ensure the maintenance of ethical standards in a company. In Luckin's case, several moral agents including management have failed to fulfil their moral responsibilities, which led to the accounting scandal and fraud.

Source: https://sevenpillarsinstitute.org/case-study-luckin-coffee-accounting-fraud/, dated: 27th Aug 2021. (Accessed on 29.07.2022)

5.4.1 Budgetary Slack

Budgetary slack is a deliberate understatement of revenues and / or overstatement of expenses in the budget. It is caused by managerial intention rather than by an unforeseen error in the estimation process. The primary aim of creating budgetary slack is that managers seek to achieve both their individual / personal goals and the organizational goals. Whether the manager feels that creating slack is ethical or unethical depends on: his / her personality traits (related to honesty and fairness) and the extent of open communications possible between the manager and his / her supervisors regarding the ability and the support necessary to achieve the desired objectives.

In organizations using output-based control systems, there are higher chances that managers will resort to creation of slack for personal benefit. In organizations using behavior-based control systems, the chances are that the managers will try to integrate the objectives of the organization with their personal objectives without creating slack.

5.4.2 Managing Earnings

Earnings management aims at reporting financial performance differently than the actual performance - usually, more robust performance is reported. It is defined as those actions undertaken by the management that have an impact on the reported income of an organization, including those not beneficial for the organization. Incidence of earnings management is higher in organizations that have poorly designed control systems due to which there is a lack of clear authority and proper auditing.

The objective behind managing earnings is an important factor to be considered, that is, whether it is used to gain rewards for oneself or to help the organization in maintaining its credit-worthiness. To prevent managers from resorting to such actions, especially for personal benefits, an organization should have audits and other control mechanisms in place to identify any occurrence of enhanced earnings and take remedial action before the financial statements are made public.

5.4.3 Ethical Issues in Sales

Most organizations try to instill a sense of responsibility and the need to sell ethically, in their salespersons as a salesperson is the representative of the organization, and the person who deals directly with customers. Ethical issues are faced in the sales function in terms of the daily work carried out, that is, in getting business for the organizations. For instance, samples and gift adjustments in the pharmaceutical industry. It is a common practice in the industry to give samples of new products to doctors as a part of sales promotion. These samples are given to the doctors so that they can try out the drug, and it also helps them in brand recall.

An example of ethical dilemma in the sales function may be given pertaining to a pharmaceutical organization where every salesperson has a monthly sales target. Generally, for target achievement, salespersons meet wholesalers and the retailers, take orders, and supply them with the necessary products. At the end of the month, if targets have not been met, some salespersons resort to promising additional discounts or special gifts for orders from distributors and chemists, so as to achieve their targets.

Activity 5.2 Suresh is a sales representative with a Fast Moving Consumer Goods (FMCG) company, which has a sales force that consists mainly of people working on short-term contracts. The company is known for setting high sales targets, and paying very high incentives. Sales personnel who achieve their specific targets are rewarded handsomely, whereas their inability to reach targets leads to penalties extending to non-renewal of the employment contract. Do you think the reward system in the company is conducive to creating an ethical work environment? Justify your answer. **Answer:**

5.4.4 Ethical Issues in Operations

Productivity is defined as the efficient use of resources to produce the desired output. The quality (which encapsulates many dimensions like performance, features, reliability, conformance, durability, serviceability, and aesthetics) of the output is the level to which the product or service satisfies the customer. Productivity and quality have to be simultaneously considered in the strategic planning process.

Ethical issues may be faced by the operations manager on the quality front in trying to maximize productivity. For instance, he / she may try to minimize the costs incurred in aspects where quality issues cannot be detected by consumers in the short-term. Another ethical issue to be considered in operations is that of the safety of employees. Safety may be compromised in trying to gain maximum profit at minimum costs, thereby making working conditions dangerous and / or unhealthy. Further, ethical issues may arise in the form of loss of important and confidential information and theft by employees. Proper security and surveillance techniques should be put in place to curb such unethical activities.

5.4.5 Ethical Issues in Human Resource Management

Issues that have become important in terms of their ethical implications for the practice of human resource management include:

Lack of job security and increased risk of unemployment

Outsourcing of business activities and downsizing of organizations, which are common phenomena in the business world today, have led to increased risk of unemployment. Organizations recruit employees on contract, paying low wages, and setting stringent performance standards, thereby increasing the sense of job insecurity among employees.

Excessive scrutiny and control

Organizations nowadays adopt various forms of scrutiny and control over employees, right from the selection stage to their performance on the job. There is a growing feeling that the extent of freedom an employee is given for decision-making is gradually being curtailed.

Discrimination

Ethical problems related to discrimination may arise due to:

- Sexual discrimination; discrimination based on religion, caste, nationality, and education
- Absence of proper performance appraisal policies
- Qualitative measures used for performance appraisal leading to biased evaluations wherein undeserving candidates are rewarded instead of deserving candidates
- Misuse of authority by management.

Exhibit 5.1 depicts an illustrative for the issues mentioned above.

Exhibit 5.1: Ethical Issues within Work Settings in Small Organizations

Ethical dilemmas arise when there is a situation that involves making a choice between options that either contradict a professional code of conduct or support offensive ideologies. Here are some of the common ethical issues dealt with an industry or company:

- **Health and Safety:**

  In case of a manufacturing company, employees are prone to engage in physically demanding work. Whereas in a standard office workplace, employees who are asked to sit or stand all through the day face health risks. There are also certain organizations that cut corners to save money on safety controls, equipment and training.

  This raises a concern for each and every employer's ethical consideration, to bring a balance between expense control and the health and safety interests of the employees.

- **Technology:**

  With the 21st century being an era of internet, mobile and cloud computing, growth and advancement in technology have produced a slew of ethical dilemmas for companies.

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Continuous monitoring of online users and email communication of computer and work accounts of employees pose a strong privacy and autonomy concern to the employees of the organization.

It is leaders who should understand and balance the privacy and freedom of employees, by maintaining the standards, in the use of technology for legitimate business purposes.

- **Transparency:**

  Prominent business and accounting scandals have made it imperative that companies operate with openness and transparency. Being caught in a lie or avoiding full disclosure may cause irreparable harm to small businesses.

  The companies are obligated to induce transparency in matters of honesty, accuracy and openness that increase the ease of communicating messages clearly, representing the intentions of the company.

- **Fair Working Conditions:**

  Fair pay and benefits are the two most obvious elements of a fair workplace. Companies generally expect to provide fair working conditions for their employees.

  This provision of a non-discriminatory work environment, involves cost to the company in terms of diversity management and training.

Thus, these ethical issues may be specific to an industry or a company. Handling ethical decisions with diligence and wisdom are essential elements for all businesses, given with the potential demoralizing effects that the company faces. If not handled properly, it leads to unethical practices and jeopardize the work culture of the organizations, irrespective of being a large, small or a public corporation.

Source: Neil Kokemuller, Common Types of Ethical Issues within Organizations, http: / / smallbusiness.chron.com/common-types-ethical-issues-within-organizations-15238.html

5.5 Regulating Ethical Conduct

Employees are often under tremendous pressure to achieve organizational goals. This makes them adopt unethical practices to expedite the work. A supervisor may ask his subordinate to complete a particular task within a shorter period of time. In such a situation, he may compromise on the quality of the product. In order to prevent employees from adopting such unethical practices, the organization should conduct ethics programs. The focus of such programs rest on developing a corporate code of conduct, which should be followed by all employees. The objective is to regulate the ethical conduct of the employees.

Towards regulating the ethical conduct of employees, the management control systems in any organization have three interconnected parts, all of which need to be effective. These parts are:

- *Indicating and communicating the objectives of the organization to all the levels in the organization:* To give the employees the direction to perform.
- *Measuring performance through a set performance measurement system:* To give the employees the necessary feedback.
- *Integrating the reward systems of the organization with the accomplishment of objectives and in turn encouraging the employees to perform:* To help the employees integrate their personal goals with organizational goals.

The different mechanisms used by organizations to regulate ethical behavior are: Code of Ethics, Ethics Committee, ethics training for employees, corporate governance focused on ethics, system of whistleblowing, and reward systems based on ethics.

Table 5.2 highlights the ethical control mechanisms that are part of the management control systems used by organizations.

Table 5.2: Management Control Systems and Ethical Control Mechanisms

1. Control Activity
2. Mechanism to Regulate Ethical Conduct
3. Indicating and communicating objectives
    - Code of ethics
    - Ethics committee
    - Ethics training for employees
    - Corporate governance focused on ethics
4. Feedback through performance measurement systems
    - Ethics committee
    - System of whistleblowing
5. Reward systems integrated with objectives accomplishment
    - Reward systems focused on ethics

Adapted from Lindsay, Murray; Linda M. Lindsay; and Bruce Irvine. "Instilling Ethical Behavior in Organizations: A Survey of Canadian Companies." Journal of Business Ethics. Vol. 15 Issue 4, April 1996, p393-407.

Example: A Closer Look at Amazon: Are Unethical Working Conditions on the Rise?

Amazon’s reputation took quite a hit in recent years for ill-treatment of its workers. Many workers reported that unhealthy working conditions and long shifts without breaks or rest room access were part of their work life. Amazon was also well known for union-busting. Amazon has prevented workers from protecting themselves on issues such as fair working conditions and proper wages. Amazon has also resorted to create fake accounts in an effort to salvage their reputation and refute worker claims. Amazon was accused of mistakenly firing people on medical leave for no-shows, not fixing inaccuracy in their payroll systems resulting in a section of both its blue-collar and white-collar employees going under-paid for months, and violating employment laws by deliberately denying unpaid leaves. Amazon faced various critiques over the quality of its working environments and treatment of its workforce. A group, known as The FACE (Former and Current Employees) of Amazon, regularly used social media to disseminate criticism of the company and allegations regarding negative work conditions.

Source: Beau Peters, https://thegeopolitics.com/a-closer-look-at-amazon-are-unethical-working-conditions-on-the-rise/ dated: April 14, 2021. (Accessed on 02.08.2022).

5.5.1 Code of Ethics

An organization's Code of Ethics is a document which gives details about the expected behaviors from each level of management. It covers the relationship of the top management with the employees, the relationships of employees among themselves, bribery, and disclosure of confidential information, customer relationships, accounting, and legal and political actions. The Code should include: clauses on the behavior of employees with each other and have rules in place which curb behaviors like unhealthy rivalry between individuals or departments. An organization must update its Code of Ethics as often as necessary, so as to ensure that it remains capable of dealing with new types of unethical practices that may arise over time in the business environment.

5.5.2 Ethics Committee

Ethics Committee should ideally be a high-powered committee at the board level, or should be directly reporting to the board. It has to strike a balance between the ethical issues cropping up due to the strategic decisions taken at the top management level, and the ethical problems that the employees face at various functional levels. Some of the responsibilities of the Ethics Committee are:

- Ascertaining that all employees are appropriately trained in the organization's code of ethics
- Communicating the importance of ethical values and ethical business practices

- Establishing proper systems for monitoring the ethical implications of activities and performance, and penalizing unethical activities, if any
- Creating avenues for employees to openly discuss ethical issues that they face, for example, creating and maintaining an ethics hotline
- Reviewing the code of ethics periodically, and revising it as and when required.

5.5.3 Ethics Training for Employees

Ethics training for employees is the basic process by which the ethical conduct and decision- making power of employees can be improved. It should help employees decide the ethical implications of their decisions and actions. An ethics training program should:

- Strengthen the organization's stand on ethics
- Give the employees the guidelines regarding bringing to light - wrong behavior
- Make the employees aware of the likely penalties for wrong-doing.

The ethics training program should provide modules for all levels of employees. Organizations should devise the training program, which clearly communicates the core values of the organization.

5.5.4 Corporate Governance and Ethics

According to Sir Adrian Cadbury, "Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society".

It is through corporate governance that the organization tries to strike a balance between its own objectives and the well-being of society, as it clearly spells out the duties and rights of all the concerned people from employees to the stakeholders. It is necessary that corporate governance be integrated with the ethical code of the organization.

For successful integration of corporate governance with the code of ethics, the top management of an organization must:

- Recognize the value and belief systems of the organization and evaluate them for appropriateness
- Assess their own thoughts and attitudes toward the ethical concerns of the organization
- Assess the existing strategies and processes of the organization to check whether they promote ethical behavior and display the ethical values.

For the proper conformity between ethics and corporate governance, it is necessary that the behavior of the top management and all employees be monitored to check for compliance with the ethical code at all levels as well as with the mission statement and functional strategies of the organization.

5.5.5 Whistleblowing

Whistleblowing is the act whereby an employee of an organization informs the higher authorities or public about the unethical practices taking place in the organization. Whistleblowers have helped organizations in tracking and curbing unethical practices, which would otherwise have damaged the reputation of the organization and also caused harm to the well-being of other employees. Albeit the benefits, whistleblowing as a control mechanism, is not an easily accepted approach in many organizations. In some organizations, whistleblowers' reports may be overlooked by the concerned people, and the unethical practices in the organization may continue. Often, whistleblowers are perceived as a threat to the top management's authority and this may lead to the whistleblower being reprimanded for his/her act. For example, refer Exhibit 5.2.

Exhibit 5.2: The Wretched Success Case and Report of Whistleblowers in Corporate India

Dinesh Thakur, a US citizen of Indian origin, in the year 2004, exposed how India's then largest drug maker and his former employer, Ranbaxy Laboratories, failed to conduct proper safety and quality tests on drugs and lied to regulators about its procedures. At that time, his evidence was ignored. Dinesh Thakur was accused of misconduct in his company. He resigned his job in 2005, and two years later made a complaint under the US False Claims Act (FCA), also known as ‘Whistleblowers Law’. The government investigated Thakur’s complaint. It took over the case when it found sufficient basis to proceed. In 2013, the US regulators.

fined Ranbaxy with USD 500 million, for violating the federal drug safety laws and making false statements to the Food and Drug Administration (FDA). Dinesh Thakur made his name, and was awarded USD 48 million from the United States (US) as a whistleblower award.

A Forensic Survey India Report by Deloitte, published on June 2014, stated that it is the casual ‘tick in the box’ approach that companies adopted, while planning and implementing a whistleblower program. Rohit Mahajan, the Senior Director and the Head of Forensic, Deloitte, India, noted: “Companies see a whistleblowing channel, as one among the many sources that can detect fraud. For that reason, companies need to build an employee / stakeholder-friendly whistleblowing program”.

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According to the survey, the key highlights of the report are:

- Around 90% respondents stated that establishing a whistleblower hotline could help reduce fraud and only 68% were actually equipped with such a hotline or helpline,
- Around 43% respondents felt that a helpline run by an independent service provider, reporting to the Audit Committee would be effective,
- About 38% respondents preferred a service that offered varied platforms as modes of access or communication channels, crucial for an effective whistleblowing hotline, and
- Others preferred communication modes via e-mail based service (28%), by post (20%), toll-free number (8%), website (5%) and fax-number (1%).

Hence, based on the results, the report stated that to build compatible whistleblowers hotline channel in India, companies had to build a supportive environment for whistleblowers, drawing on firms' experiences and adopting prevalent best practices.

Source: Adapted from India's success in corporate whistle blowing dismal: Deloitte, http://www.business-standard.com/article/companies, 2014, Sandhya Srinivasan, Cheap drugs and the millionaire whistleblower, 2014, Ranbaxy whistleblower Dinesh Thakur takes India's health ministry, drug regulators to SC, http://www.dnaindia.com/money/report-pharma-crusader-takes-india-s-drug-regulators-to-court, 2016.

5.5.6 Reward Systems and Ethics

It is necessary for organizations to incorporate reward systems which promote ethical means of achieving the specified objectives. Integrating ethics into the reward systems will increase the commitment of the employees toward the ethical program of the organization. The system should ensure rewards for employees who show good judgmental capabilities or take proactive decisions that benefit the organization.

Check Your Progress - 2

6. What is defined as a deliberate undervaluation of revenues and/or exaggeration of expenses in the budget to achieve preset budgetary objectives?
   a. Budgetary valuation
   b. Budgetary slack
   c. Budgetary excesses
   d. Self-seeking maximizer
   e. Financial budget

7. Identify the nature of activity in a pharma that concerns the ethical aspect in the distribution of samples and gifts.
   a. Finance
   b. Sales
   c. Operations
   d. Human resources
   e. Technical
8. Identify the document which gives details about the expected relationship of the top management with the employees, the relationships of employees among themselves, bribery, disclosure of confidential information, customer relationships, accounting, and legal and political actions.
   a. Ethics committee
   b. Ethical decision ideology
   c. Code of ethics
   d. Ethical philosophy
   e. Ethical practice
9. Identify the activity whereby an employee of the organization informs the public or higher authorities about the unethical practices taking place in the organization.
   a. Corporate governance
   b. Code of ethics
   c. Whistleblowing
   d. Ethics training
   e. Self-seeking maximizer
10. What is the process through which the ethical conduct and decision-making power of the employee is improved?
   a. Whistleblowing
   b. Ethics training
   c. Code of ethics
   d. Corporate governance
   e. Ethical practice

5.6 Summary

- Ensuring ethical behavior among employees requires an in-depth understanding of many factors which contribute to their decisions to behave ethically or otherwise. Organizations attempt to ensure that their employees behave ethically, using control systems.

- The ethical behavior of an employee depends on factors such as the individual's ethical philosophy, that is, utilitarianism, individual rights, or justice; ethical decision ideology, that is, absolutist, exceptionist, situationist, or subjectivist; other individual factors, organizational / position-related factors, and external environmental factors.
- In the context of management control, ethical issues can arise in any department or function of an organization.
- On the financial front, the ethical issues may arise due to creation of budgetary slack and managing earnings.
- Ethical issues in the sales function arise when the salespeople are under pressure from the higher authorities to achieve targets in order to earn incentives or recognition. In the operations function, ethical issues may arise in terms of productivity and quality or on the safety front. In human resource management, lack of job security and increased risk of unemployment, excessive scrutiny and control over employees, and discrimination are some issues that are important in terms of their ethical implications.
- To regulate ethical conduct, organizations have in place different mechanisms like Code of Ethics, Ethics Committee, Ethics training for employees, corporate governance focused on ethics, system of whistleblowing, and reward systems based on ethics.

5.7 Glossary

Budgetary slack: Organizational slack, when created as a part of the budgeting activity, is called budgetary slack. It is the amount that is budgeted in excess of the actual requirement. It is a deliberate understatement of revenues and / or overstatement of expenses in the budget.

Code of ethics: An organization's code of ethics is a document which gives details about the expected behaviors from each level of management. This code gives the policies that are in place related to ethics and also the method of implementing them.

Corporate governance: Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations, and society.

Ethical decision ideologies: Ethical decision ideologies can be classified based on two dimensions: idealism (the belief that behaving ethically ensures positive results); and relativism (the belief that moral values depend on circumstances). Based on these two dimensions, there are four classifications of ethical decision ideologies - absolutist, exceptionist, situationist, and subjectivist.

Ethical system: The ethical system of an individual consists of his / her ethical philosophy and ethical decision ideology. An individual's ethical philosophy represents the collection of ethical principles that he / she holds. Ethical decision ideology is concerned with how different individuals apply their ethical philosophies for decision-making when faced with ethical dilemmas.

Ethics committee: The Ethics Committee is responsible for reporting on the ethical aspects of the organization to the top management and board, thus emphasizing the importance of ethical values to the employees. It has to strike a balance between the ethical issues cropping up due to the strategic decisions taken at the top management level, and the ethical problems that the employees face at all levels of functioning.

Ethics: Ethics is derived from the Latin word 'ethicus' meaning manners or character. Ethics deals with morality and rules regarding behavior and conduct. In an organizational set-up, ethics can be defined as the rules or standards governing the conduct of individuals and organizations.

Whistleblowing: Whistleblowing is an act whereby an employee of an organization informs the public or higher authorities about the unethical practices taking place in the organization. Whistleblowers have helped a lot of organizations in tracking and curbing unethical practices, which would otherwise have damaged the reputation of the organization and also caused harm to the well-being of other employees.

5.8 Self-Assessment Exercises

1. What is ethical philosophy? Describe the three different ethical philosophies.
2. Define ethical ideology. What are the two dimensions on which it is based?
3. Match the following:

   Ethical Decision Ideology

   i. Absolutist

   ii. Exceptionist

   iii. Situationist

   iv. Subjectivist Description

   a. A person with a low score on both idealism and relativism

   b. A person who scores high both on idealism and relativism

   c. A person who scores low on idealism and high on relativism

   d. A person who scores high on idealism and low on relativism
4. Enumerate the different factors that affect the ethical behavior of employees. Describe any one of them in detail.
5. Describe the ethical issues that can arise in the operations function of any organization.

6. Write short notes on the following:
   - Code of Ethics
   - Ethics Committee
   - Ethics training for employees
   - Corporate governance focused on ethics
   - Whistleblowing
   - Reward systems based on ethics

5.9 Suggested Readings / Reference Material

1. Stephen P Robbins, David A. De Cenzo and Mary Coulter. *Fundamentals of Management: Essential Concepts and Applications*, Fifteenth Edition| By Pearson Paperback – 30 June 2022.
2. Subhash Chandra Das, Management Control Systems – Principles and Practices, PHI Learning Pvt. Limited, Paperback – 15 July 2019.
3. Pravin Durai, Principles of Management: Text and Cases, First edition, Pearson India Education Services Pvt. Ltd.; Second edition (31 August 2019).
4. Xianzhi Zhang, Enterprise Management Control Systems in China, First edition, Springer-Verlag Berlin Heidelberg, 23 Sep 2016.
5. Prof. Kenneth Merchant and Prof. Wim Van der Stede, Management Control Systems: Performance Measurement, Evaluation and Incentives, Third edition, Prentice Hall, 2011.

5. 10 Answers to Check Your Progress Questions

1. (c) Ethical decision ideology

Ethical decision ideologies can be classified based on two dimensions: idealism **-** the belief that behaving ethically ensures positive results; and relativism **-** the belief that moral values depend on circumstances.

2. (d) Absolutist

Soham can be classified as an 'absolutist' as he scores high on idealism and low on relativism. An absolutist believes in strictly following the universally accepted ethical principles.

3. (b) Ego strength

The various organizational factors that influence the behavior of employees are: organizational structure and culture, performance measurement systems, reward systems, the decision-making authority, position-related factors, etc. Ego strength is an individual factor that influences the behavior of an employee in an organization.

4. (c) Employee stock option plans

Employee stock options are the option of buying shares in the company at a discounted price and are an example of monetary reward. Monetary rewards also include incentives and bonuses. Non-monetary rewards are given in the form of memberships to resorts and clubs, all-expenses paid vacations, etc. Offering or accepting a kickback is a type of unethical behavior.

5. (d) Ethical system

Political and economic factors, social factors, and the legal environment in which the organization operates are some of the external environmental factors that influence ethical behavior. The ethical system is an individual-level factor; it consists of the individual's ethical philosophy and ethical decision ideology.

6. (b) Budgetary slack

Budgets are usually prepared by the top level management of the organization. Budgetary slack is a deliberate understatement of revenues and / or overstatement of expenses in the budget. In other words, the manager is understating his / her productive capacity.

7. (b) Sales

Ethical issues do not arise only in the social scenario; they are also faced in terms of the daily work carried out, that is, in getting business for the organizations. One such issue is that of samples and gift adjustments in the pharmaceutical industry, where it is the normal practice to give samples of new products to doctors as a part of the sales promotion. The intention behind these samples being given to the doctors is to allow them to try out the drug. It also helps them in brand recall. These samples are meant to be given free to needy patients by the doctors. An unethical practice in this regard is to divert these samples to distributors and chemists who can make money by selling them in the market, thus, going against the interests of the pharmaceutical company as well as the patients.

8. (c) Code of Ethics

An organization's Code of Ethics is a document which gives details about the expected behaviors from each level of management. An organization must update its Code of Ethics as often as necessary, so as to ensure that it remains capable of dealing with new types of unethical practices that may arise over time in the business environment.

9. (c) Whistleblowing

Whistleblowing helps in tracking and curbing unethical practices, which would otherwise have damaged the reputation of the organization and also caused harm to the well-being of other employees.

10. (b) Ethics training

Ethics training should help the employees understand the ethical implications of their decisions and actions.

Management Control Systems

Course Structure

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Unit 18	Control and Governance of Information Systems
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