

An aerial photograph of a large, colorful geometric plaza. The plaza is composed of various colored rectangular sections in shades of light blue, dark blue, red, and green. A large green square is the central focus, with several people walking on it. Other people are scattered across the other colored sections. The overall design is reminiscent of Piet Mondrian's abstract art style.

7th Asia-Pacific Edition

MANAGEMENT

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Managerial quality and performance

CHAPTER 19



CHAPTER 19

Managerial quality and performance

1

Define organisational control and explain why it is a key management function

2

Explain the four steps in the feedback control process and the benefits of using the balanced scorecard to track the organisation's performance and control

3

Explain the methods of budgetary control for planning and tracking all money flows and supporting good managerial decisions

4

Discuss the use of financial statements, financial analysis and budgeting as management controls

5

Recognise the changing philosophy of control: contrast the hierarchical and decentralised methods of control and identify the benefits of open-book management

6

Describe the concept of total quality management (TQM) and major TQM techniques, such as quality circles, benchmarking, Six Sigma principles, quality partnering and continuous improvement

7

Identify current trends in quality and financial control, including ISO 9000 and electronic monitoring, and discuss their impact on organisations

8

Identify the qualities of effective control systems



	Mostly true	Mostly false
1 I spend time developing new ways of approaching old problems.		
2 So long as things are done correctly and efficiently, I prefer not to take on the hassle of changing them.		
3 I believe the effort to improve something should be rewarded, even if the final outcome is disappointing.		
4 A single change that improves things 30 per cent is much better than 30 improvements of 1 per cent each.		
5 I frequently compliment other people on changes that they have made.		
6 I let people know in a variety of ways that I need to be on my own to do my job efficiently.		
7 I am typically involved in several improvement projects at one time.		
8 I try to be a good listener and to be patient with what people say, except when it is a stupid idea.		
9 I am frequently proposing unconventional techniques and ideas to improve things.		
10 I usually do not take the risk of proposing an idea that might fail.		



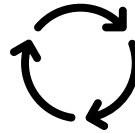
THE MEANING OF CONTROL

- Refers to the systematic process through which managers regulate organisational activities to make them consistent with expectations established in plans, targets and standards of performance
- Organisations need to ensure their financial and operational systems are well under control
- Standards, measurements and metrics are needed to monitor and control the organisation effectively
- Quality and safety



FEEDBACK CONTROL MODEL

- Control that focuses on the organisation's outputs
- Also called **post-action** or **output** control
- Involves several steps



STEPS OF FEEDBACK CONTROL

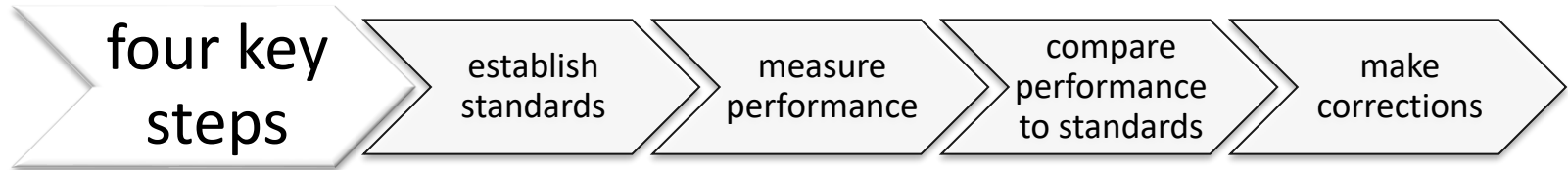
Four key steps:

- Establish standards of performance
 - standards relate to strategic goals
- Measure actual performance
- Compare performance to standards
- Take corrective action



FEEDBACK CONTROL MODEL

- Monitoring and regulating an organisation's activities and using feedback
- Determine whether performance meets established standards
- Better control is strongly correlated with better organisational productivity and performance



FEEDBACK CONTROL MODEL

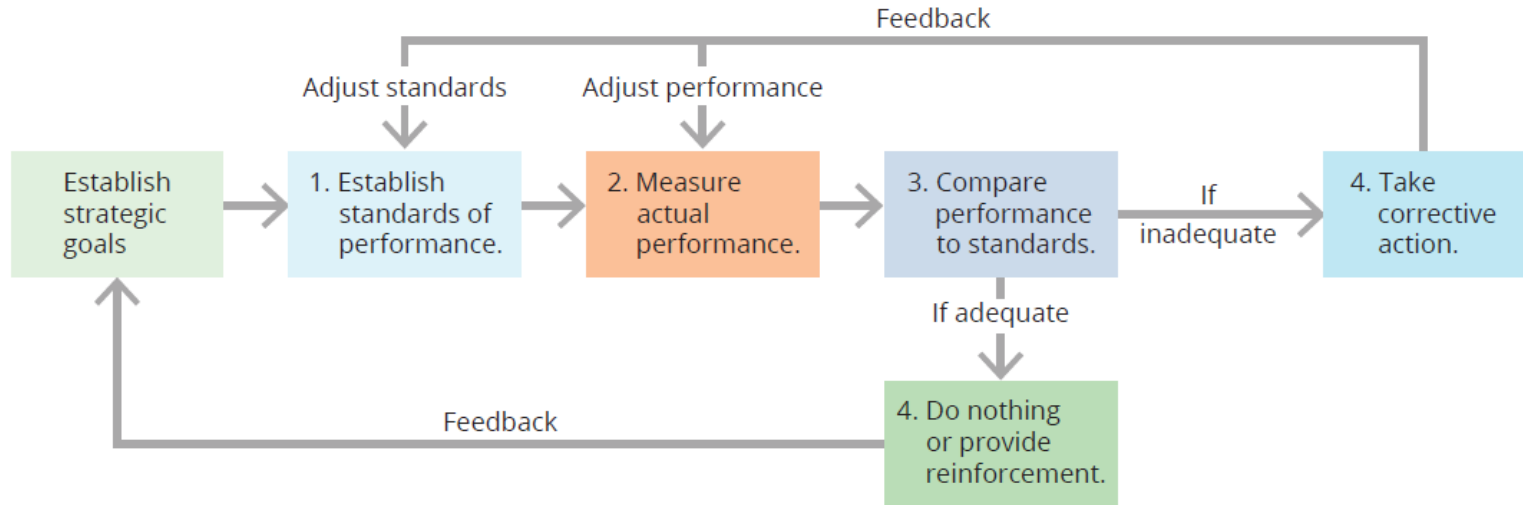
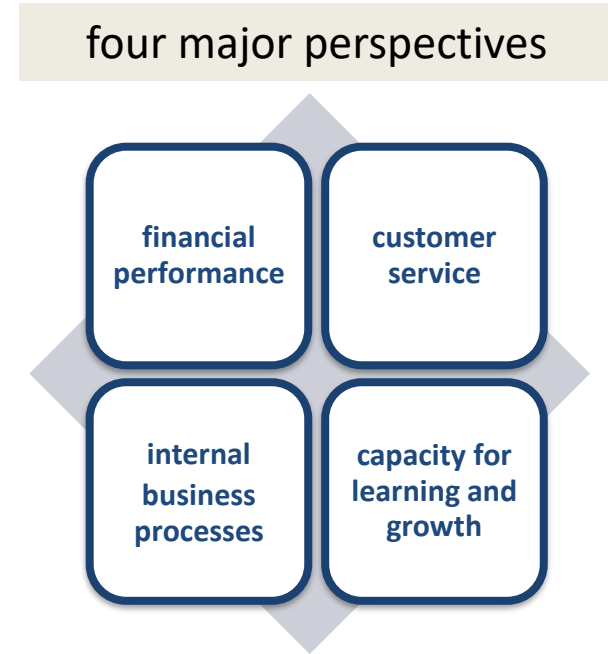


Exhibit 19.1 Feedback control model



THE BALANCED SCORECARD

- Is a management control system that **balances** traditional financial measures with operational measures relating to a company's critical success factors
- A comprehensive management control system



THE BALANCED SCORECARD

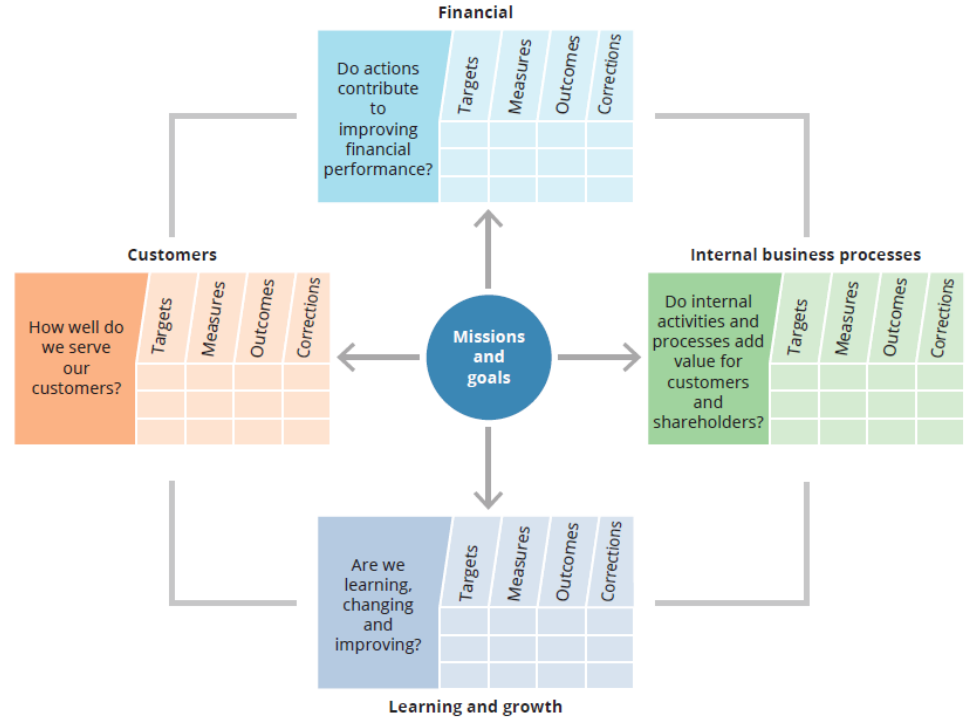


Exhibit 19.2 The balanced scorecard

Sources: Based on Robert S. Kaplan and David P. Norton. (January–February 1996). 'Using the Balanced Scorecard as a Strategic Management System'. *Harvard Business Review*, 75–85; and Chee W. Chow, Kamal M. Haddad and James E. Williamson. (August 1997). 'Applying the Balanced Scorecard to Small Companies'. *Management Accounting*, 79:2, 21–7.



BUDGETARY CONTROL

- All organisations need to prepare financial budgets
- **Budgets** detail the financial expectations of the organisation over the next 12 months
- Commonly used:
 - expense budget
 - revenue budget
 - cash budget
 - capital budget
 - zero-based budget (contd.)

budgetary control

- Setting specific financial plans in place, then managing in real time to achieve those plans, carefully attending to variations between plans and 'actuals'

responsibility centre

- An organisational unit under the supervision of a single person who is responsible for its activity



BUDGETARY CONTROL (CONTD.)

Expense Budget

- Outlines the anticipated and actual expenses for a responsibility centre

Revenue budget

- Identifies the forecasted and actual revenues

Cash budget

- Estimates and reports cash flows on a daily or weekly basis

Capital budget

- Plans and reports investments in major assets to be depreciated over several years

Zero-based budget

- Requires a complete justification for every line item in a budget



BUDGETARY CONTROL (CONTD.)

- Budgeting is an important part of organisational **planning** and **decision making**
- Top-down budgeting
 - a budgeting process in which middle- and lower-level managers set departmental budget targets in accordance with overall organisation revenues and expenditures specified by top management
- Bottom-up
 - Process whereby lower-level managers budget their departments' resource needs and pass them up to top management for approval
 - More **empowering**



FINANCIAL CONTROL

- **Financial statements** provide the basic information used for financial control
- Two **major** financial statements:
- The balance sheet
 - shows the firm's financial position with respect to assets and liabilities at a specific point in time
- Income statement
 - summarises the firm's financial performance for a given time interval
 - also called a **profit-and-loss** statement



FINANCIAL ANALYSIS

- A manager needs to be able to interpret and evaluate financial reports
- Most financial analysis focus on ratios
 - showing relationships between performance indicators such as profits and assets, sales and inventory
- Most **common** types:
 - liquidity ratios
 - activity ratios
 - probability ratios
 - leverage ratios (contd.)



BALANCE SHEET

New Creations Landscaping consolidated balance sheet 31 December 2015					
Assets			Liabilities and owners' equity		
Current assets:	\$	\$	Current liabilities:	\$	\$
Cash	25 000		Accounts payable	200 000	
Accounts receivable	75 000		Accrued expenses	20 000	
Inventory	<u>500 000</u>		Income taxes payable	<u>30 000</u>	
Total current assets		600 000	Total current liabilities		250 000
Fixed assets:			Long-term liabilities:		
Land	250 000		Mortgages payable	350 000	
Buildings and fixtures	1 000 000		Bonds outstanding	<u>250 000</u>	
			Total long-term liabilities		600 000
Less depreciation	<u>200 000</u>		Owners' equity:		
Total fixed assets		<u>1 050 000</u>	Common stock	540 000	
			Retained earnings	<u>260 000</u>	
			Total owners' equity		<u>800 000</u>
Total assets		<u>1 650 000</u>	Total liabilities and net worth		<u>1 650 000</u>

Exhibit 19.3 Balance sheet



INCOME STATEMENT

New Creations Landscaping income statement for the year ended 31 December 2015		
Gross sales	\$3 100 000	
Less sales returns	<u>200 000</u>	
Net sales		2 900 000
Less expenses and cost of goods sold:		
Cost of goods sold	2 110 000	
Depreciation	60 000	
Sales expenses	200 000	
Administrative expenses	<u>90 000</u>	<u>2 460 000</u>
Operating profit		440 000
Other income		20 000
Gross income		460 000
Less interest expense	80 000	
Income before taxes		380 000
Less taxes	165 000	
Net income		<u>\$ 215 000</u>

Exhibit 19.4 Income statement



FINANCIAL ANALYSIS: INTERPRETING THE NUMBERS

Liquidity ratio

- Indicates organisation's ability to meet its current debt obligations (assets/liabilities)

Activity ratio

- Measures internal performance of key activities (total sales/average inventory) (contd.)

Profitability ratio

- Describes the firm's profits in terms of a source of profits
- Sales or total assets

Leverage ratio

- Funding activities with borrowed money



THE CHANGING PHILOSOPHY OF CONTROL

- Managers are adopting a **decentralised** rather than a **hierarchical** control process
- Based on different philosophies of corporate culture
- Most organisations have **both** hierarchical and decentralised control
- Emphasis on one or the other type depends on:
 - organisational culture
 - managers' beliefs about control

hierarchical control

- The use of rules, policies, hierarchy of authority, reward systems and other formal devices to influence employee behaviour and assess performance

decentralised control

- The use of organisational culture, group norms and a focus on goals, rather than rules and procedures, to foster compliance with organisational goals



HIERARCHICAL AND DECENTRALISED METHODS OF CONTROL

	Hierarchical control	Decentralised control
Basic assumptions	People are incapable of self-discipline and cannot be trusted. They need to be monitored and controlled closely.	People work best when they are fully committed to the organisation.
Actions	<p>Uses detailed rules and procedures; formal control systems.</p> <p>Uses top-down authority, formal hierarchy, position power, quality control inspectors.</p> <p>Relies on task-related job descriptions.</p> <p>Emphasises extrinsic rewards (pay, benefits, status).</p> <p>Features rigid organisational culture; distrust of cultural norms as means of control.</p>	<p>Features limited use of rules; relies on values, group and self-control, selection and socialisation.</p> <p>Relies on flexible authority, flat structure, expert power; everyone monitors quality.</p> <p>Relies on results-based job descriptions; emphasises goals to be achieved.</p> <p>Emphasises extrinsic and intrinsic rewards (meaningful work, opportunities for growth).</p> <p>Features adaptive culture; culture recognised as means for uniting individual, team and organisational goals for overall control.</p>
Consequences	<p>Employees follow instructions and do just what they are told.</p> <p>Employees feel a sense of indifference towards work.</p> <p>Employee absenteeism and turnover is high.</p>	<p>Employees take initiative and seek responsibility.</p> <p>Employees are actively engaged and committed to their work.</p> <p>Employee turnover is low.</p>

Exhibit 19.6 Hierarchical and decentralised methods of control



OPEN-BOOK MANAGEMENT

- **Sharing** financial information and results with all employees in the organisation
- A decentralised control system
- Goal is to get **every employee** thinking and acting like a **business owner**
- Not always favoured in some countries:
 - prevailing attitudes around secrecy and confidentiality



TOTAL QUALITY MANAGEMENT

- Refers to organisation-wide effort to infuse quality into every activity in a company through continuous improvement
- Techniques include:
 - quality circles
 - benchmarking
 - Six Sigma (contd.)

total quality management (TQM)

- A concept that focuses on managing the total organisation to deliver quality to customers. Four significant elements of this are employee involvement, focus on the customer, benchmarking and continuous improvement



TQM TECHNIQUES

Quality circles

- Group of six to 12 volunteer employees meet regularly to discuss and solve problems affecting the quality of their work

Benchmarking

- Continuous process of measuring products, services and practices against major competitors or industry leaders

Six Sigma

- A quality control approach that emphasises a relentless pursuit of higher quality and lower costs

Quality partnering

- A quality control approach that involves assigning dedicated personnel within a particular functional area of the business

Continuous improvement

- The implementation of a large number of small, incremental improvements in all areas of the organisation on a continuing basis



THE QUALITY CIRCLE PROCESS

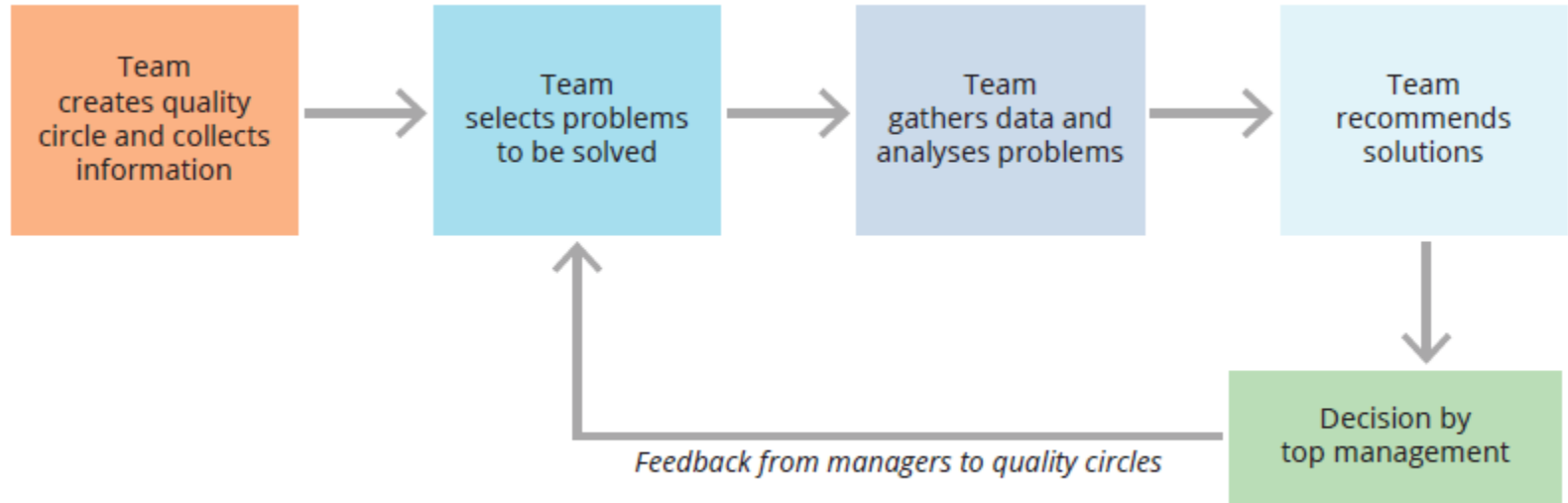


Exhibit 19.7 The quality circle process



THE IMPORTANCE OF QUALITY IMPROVEMENT PROGRAMS

99 per cent amounts to:	Six Sigma amounts to:
117 000 pieces of lost first-class mail per hour	1 piece of lost first-class mail every two hours
800 000 mishandled personal cheques each day	3 mishandled cheques each day
23 087 defective computers shipped each month	8 defective computers shipped each month
7.2 hours per month without electricity	9 seconds per month without electricity

Exhibit 19.9 The importance of quality improvement programs

Source: Based on data from *Statistical Abstract of the United States*, US Postal Service, as reported in Mayor, T. (1 December 2003). 'Six Sigma Comes to IT: Targeting Perfection'. *CIO*, 62–70.



TQM SUCCESS FACTORS

Positive factors	Negative factors
Tasks make high skill demands on employees.	Management expectations are unrealistically high.
TQM serves to enrich jobs and motivate employees.	Middle managers are dissatisfied about loss of authority.
Problem-solving skills are improved for all employees.	Workers are dissatisfied with other aspects of organisational life.
Participation and teamwork are used to tackle significant problems.	Union leaders are left out of quality-control discussions.
Continuous improvement is a way of life.	Managers wait for big, dramatic innovations.

Exhibit 19.10 Quality program success factors



TRENDS IN QUALITY AND FINANCIAL CONTROL

- International quality standards
 - a **universal** benchmark for quality management practices
 - **ISO 9000**
 - sets uniform guidelines for processes to ensure products conform to requirements and for evaluating and comparing companies on a global basis
- Electronic monitoring
 - use of remote sensors and GPS devices to computers for analysis
 - employee reactions to electronic monitoring are often negative

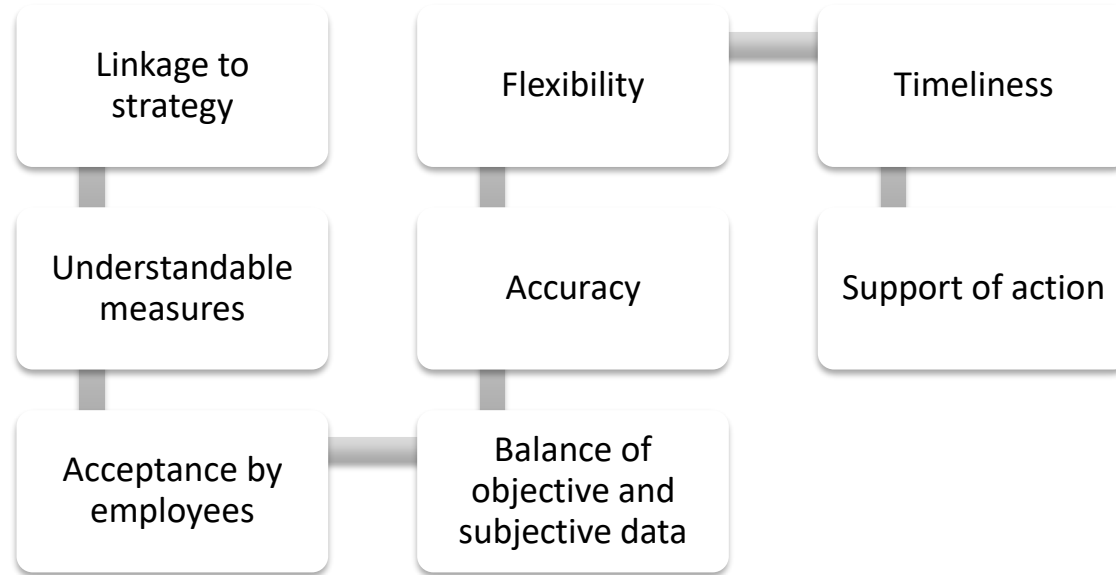


QUALITIES OF EFFECTIVE CONTROL SYSTEMS

- Effective controls help managers respond to **unforeseen** developments and achieve **strategic plans**
- Failure can lead to organisation's demise



QUALITIES OF EFFECTIVE CONTROL SYSTEMS



SUSTAINABLE DEVELOPMENT AND MANAGEMENT CONTROL

- Sustainability needs to be **built** into system
- Focus on:
 - environmental
 - financial
 - social outcomes
- Must be :
 - well planned
 - well resourced and
 - well controlled



CHAPTER 19 – BRIEF SUMMARY

19.1 Organisational control is the systematic process through which managers regulate activities to meet planned goals and standards of performance.

19.2 Feedback control provides valuable performance information that can be used to make effective decisions and improve processes

19.3 Budgetary control is one of the most commonly used forms of managerial control. It is the process of setting targets for an organisation's expenditures, monitoring results and comparing them to the budget, and making changes as needed.

19.4 Financial statements provide the basic information used for financial control of an organisation.

19.5 The philosophy of control has shifted to reflect changes in leadership methods.

19.6 Total quality management (TQM) is an organisation-wide effort to infuse quality into every activity in a company through continuous improvement.

19.7 As global business expands, many companies have adopted a universal benchmark for quality management practices, including ISO 9000 standards, which represent an international consensus of what constitutes effective quality management as outlined by the International Organization for Standardization (ISO).

19.8 Some key qualities of an effective control system are linking strategy, understandable measures, having accurate timely data that supports decisions and action, yet being flexible as needed so that controls will be reasonable and accepted by employees.

