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Unit 8: Controlling

Name: _____

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Meaning

Controlling means ensuring that activities in an organisation are performed as per the plans. Controlling also ensures that an organisation's resources are being used effectively and efficiently for the achievement of predetermined goals

Importance of Controlling

A good control system helps an organisation in the following ways:

1. Accomplishing organisational goals: The controlling function measures progress towards the organisational goals and brings to light the deviations, if any, and indicates corrective action. It, thus, guides the organisation and keeps it on the right track so that organisational goals might be achieved.

2. Judging accuracy of standards: A good control system enables management to verify whether the standards set are accurate and objective. An efficient control system keeps a careful check on the changes taking place in the organisation and in the environment and helps to review and revise the standards considering such changes.

3. Making efficient use of resources: By exercising control, a manager seeks to reduce wastage and spoilage of resources. Each activity is performed in accordance with predetermined standards and norms. This ensures that resources are used in the most effective and efficient manner.

4. Improving employee motivation: A good control system ensures that employees know well in advance what they are expected to do and what are the standards of performance based on which they will be appraised. It, thus, motivates them and helps them to give better performance.

5. Ensuring order and discipline: Controlling creates an atmosphere of order and discipline in the organisation. It helps to minimise dishonest behaviour on the part of the employees by keeping a close check on their activities. The box explains how an import export company was able to track dishonest employees by using computer monitoring as a part of their control system.

6. Facilitating coordination in action: Controlling provides direction to all activities and efforts for achieving organisational goals. Each department and employee is governed by predetermined standards which are well coordinated with one another.

Limitations of Controlling

    (i)   <u>Difficulty in setting quantitative standards:</u> Control system loses some of its effectiveness when standards cannot be defined in quantitative terms. This makes measurement of performance and their comparison with standards a difficult task. Employee morale, job satisfaction and human behaviour are such areas where this problem might arise.

    (ii)   <u>Little control on external factors:</u> Generally, an enterprise cannot control external factors such as government policies, technological changes, competition etc.

    (iii)   <u>Resistance from employees:</u> Control is often resisted by employees. They see it as a restriction on their freedom. For instance, employees might object when they are kept under a strict watch with the help of Closed Circuit Televisions (CCTVs).

    (iv)   <u>Costly affair:</u> Control is a costly affair as it involves a lot of expenditure, time and effort. A small enterprise cannot afford to install an expensive control system. It cannot justify the expenses involved. Managers must ensure that the costs of installing and operating a control system should not exceed the benefits derived from it.

Relationship Between Planning and Controlling

Planning and controlling are inseparable twins of management. A system of control presupposes the existence of certain standards. These standards of performance which serve as the basis of controlling are provided by planning. Once a plan becomes operational, controlling is necessary to monitor the progress, measure it, discover deviations and initiate corrective measures to ensure that events conform to plans.

Planning is basically an intellectual process involving thinking, articulation and analysis to discover and prescribe an appropriate course of action for achieving objectives. Controlling, on the other hand, checks whether decisions have been translated into desired action. Planning is thus, prescriptive whereas, controlling is evaluative.

It is often said that planning is looking ahead while controlling is looking back. However, the statement is only partially correct. Plans are prepared for future and are based on forecasts about future conditions. Therefore, planning involves looking ahead and is called a forward-looking function.

However, planning is guided by past experiences and the corrective action initiated by control function aims to improve future performance. Thus, planning and controlling are both backward-looking as well as a forward-looking function. Thus, planning and controlling are interrelated and, in fact, reinforce each other

Production	Marketing	Personnel Management	Finance and Accounting
Quantity	Sales volume	Labour relations	Capital expenditure
Quality	Sales expense	Labour turnover	Inventories
Cost	Advertising expense	Labour absenteeism	Flow of capital
Individual job	Individual		
Performance	Sales-person's performance		

Controlling Process

Step 1: Setting Performance Standards: The first step in the controlling process is setting up of performance standards. Standards are the criteria against which actual performance would be measured. Thus, standards serve as benchmarks towards which an organisation strives to work. Standards can be set in both quantitative as well as qualitative terms. For instance, standards set in terms of cost to be incurred, revenue to be earned, product units to be produced and sold, time to be spent in performing a task, all represents quantitative standards. Sometimes standards may also be set in qualitative terms. Improving goodwill and motivation level of employees are examples of qualitative standards.

Step 2: Measurement of Actual Performance: Once performance standards are set, the next step is measurement of actual performance. Performance should be measured in an objective and reliable manner. There are several techniques for measurement of performance. These include personal observation, sample checking, performance reports, etc. As far as possible, performance should be measured in the same units in which standards are set as this would make their comparison easier.

Step 3: Comparing Actual Performance with Standards: This step involves comparison of actual performance with the standard. Such comparison will reveal the deviation between actual and desired results. Comparison becomes easier when standards are set in quantitative terms. For instance, performance of a worker in terms of units produced in a week can be easily measured against the standard output for the week.

Step 4: Analysing Deviations: Some deviation in performance can be expected in all activities. It is, therefore, important to determine the acceptable range of deviations. Also, deviations in key areas of business need to be attended more urgently as compared to deviations in certain insignificant areas. Critical point control and management by exception should be used by a manager in this regard.

   a) Critical Point Control: It is neither economical nor easy to keep a check on every activity in an organisation. Control should, therefore, focus on key result areas (KRAs) which are critical to the success of an organisation. These KRAs are set as the critical points. If anything goes wrong at the critical points, the entire organisation suffers. For instance, in a manufacturing organisation, an increase of 5 per cent in the labour cost may be more troublesome than a 15 per cent increase in postal charges.
   b) Management by Exception: Management by exception, which is often referred to as control by exception, is an important principle of management control based on the belief that an attempt to control everything results in controlling nothing. Thus, only significant deviations which go beyond the permissible limit should be brought to the notice of management. Thus, if the plans lay down 2 per cent increase in labour cost as an acceptable range of deviation in a manufacturing organisation, only increase in labour cost beyond 2 per cent should be brought to the notice of the management. However, in case of major deviation from the standard (say, 5 per cent), the matter must receive immediate action of management on a priority basis

Step 5: Taking Corrective Action: The final step in the controlling process is taking corrective action. No corrective action is required when the deviations are within acceptable limits. However, when the deviations go beyond the acceptable range, especially in the important areas, it demands immediate managerial attention so that deviations do not occur again and standards are accomplished. Corrective action might involve training of employees if the production target could not be met.

Causes of Deviation	Corrective action to be taken
Defective material	Change the quality specification for the material used
Defective machinery	Repair the existing machine or replace the machine if it cannot be repaired
Obsolete machinery	Undertake technological upgradation of machinery
Defective process	Modify the existing process
Defective physical conditions of work	Improve the physical conditions of work

Techniques of Control

Traditional Techniques

Personal Observation: This is the most traditional method of control. Personal observation enables the manager to collect first-hand information. It also creates a psychological pressure on the employees to perform well as they are aware that they are being observed personally on their job. However, it is a very time-consuming exercise and cannot effectively be used in all kinds of jobs.

Statistical Reports: Statistical analysis in the form of averages, percentages, ratios, correlation, etc., present useful information to the managers regarding performance of the organisation in various areas. Such information when presented in the form of charts, graphs, tables, etc., enables the managers to read them more easily and allow a comparison to be made with performance in previous periods and also with the benchmarks.

Breakeven Analysis: Breakeven analysis is a technique used by managers to study the relationship between costs, volume and profits. It determines the probable profit and losses at different levels of activity. The sales volume at which there is no profit, no loss is known as breakeven point. The figure shows breakeven chart of a firm. Breakeven point is determined by the intersection of Total Revenue and Total Cost curves. The diagram shows that the firm will break even at 50,000 units of output. At this point, there is no profit no loss. It is beyond this point that the firm will start earning profits.

$$Breakeven\ Point = \frac{Fixed\ Costs}{Selling\ price\ per\ unit - Variable\ Cost\ per\ unit}$$

Budgetary Control: Budgetary control is a technique of managerial control in which all operations are planned in the form of budgets and actual results are compared with budgetary standards. Budgeting offers the following advantages:

1. Budgeting focuses on specific and time-bound targets and thus, helps in attainment of organisational objectives.
2. Budgeting is a source of motivation to the employees who know the standards against which their performance will be appraised and thus, enables them to perform better.
3. Budgeting helps in optimum utilisation of resources by allocating them according to the requirements of different departments.
4. Budgeting is also used for achieving coordination among different departments of an organisation and highlights the interdependence between them. For instance, sales budget cannot be prepared without knowing production programmes and schedules.
5. It facilitates management by exception by stressing on those operations which deviate from budgeted standards in a significant way.
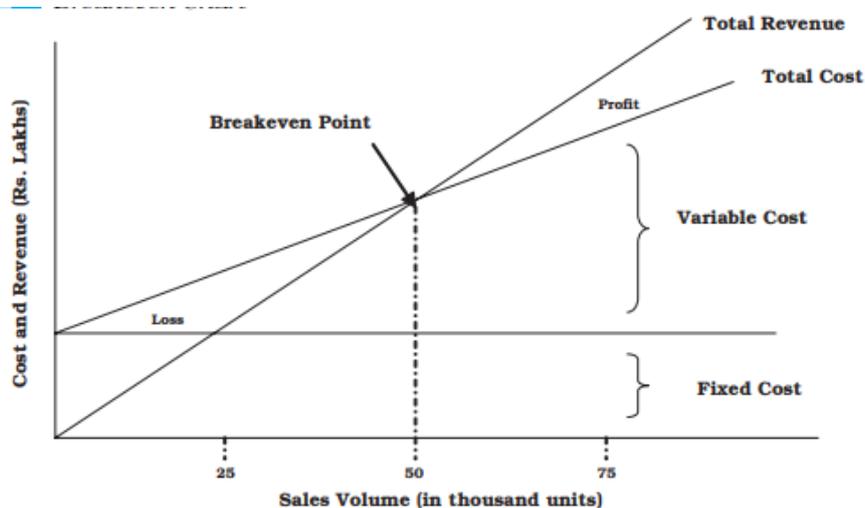
Modern Techniques

Return on Investment: Return on Investment (RoI) is a useful technique which provides the basic yardstick for measuring whether invested capital has been used effectively for generating reasonable amount of return. RoI can be used to measure overall performance of an organisation or of its individual departments or divisions. It can be calculated as under

$$ROI = \frac{Net\ Income}{Sales} \times \frac{Sales}{Total\ Income}$$

Ratio Analysis: Ratio Analysis refers to analysis of financial statements through computation of ratios. The most commonly used ratios used by organisations can be classified into the following categories:

1. Liquidity Ratios: Liquidity ratios are calculated to determine short-term solvency of business. Analysis of current position of liquid funds determines the ability of the business to pay the amount due to its stakeholders.
2. Solvency Ratios: Ratios which are calculated to determine the long-term solvency of business are known as solvency ratios. Thus, these ratios determine the ability of a business to service its indebtedness.
3. Profitability Ratios: These ratios are calculated to analyse the profitability position of a business. Such ratios involve analysis of profits in relation to sales or funds or capital employed.
4. Turnover Ratios: Turnover ratios are calculated to determine the efficiency of operations based on effective utilisation of resources. Higher turnover means better utilisation of resources. The table given below gives examples of some ratios commonly used by managers

Type of Ratio	Examples
Liquidity	Current Ratio
	Quick Ratio
Solvency	Debt-Equity Ratio
	Proprietary Ratio
	Interest Coverage Ratio
Profitability	Gross Profit Ratio
	Net Profit Ratio
	Return on Capital Employed
Turnover	Inventory Turnover Ratio
	Stock Turnover Ratio
	Debtors Turnover Ratio