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BUSINESS ORGANISATION AND MANAGEMENT – I

Unit 4 Controlling

- **Concept**
- **Nature**
- **Importance**
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- **Types of control**
- **Techniques of control:**
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  (B) Break Even Analysis: concepts, uses & limitations.

Introduction

Control is the last function of management. The controlling function will be unnecessary to the management if other functions of management are performed properly. If there is any imperfection in the planning and actual performance, control will be needed. The deviations are set right by the controlling function. This function ensures desired results. Planning identifies the activities and controlling regulates the activities. Success or failure of planning depends upon the result of success or failure of controlling.

Definition

Earnest Dale, "control envisages a system that not only provides a historical record of what has happened to the business as a whole but, pinpoints the reasons why it has happened and provides data ·that enables the chief executive on the departmental head to take corrective' steps if he finds he is on the wrong track."

E.F.L. Brech., "Control - checking current performance against pre-determined standards contained in the plans, with a view to ensure adequate progress and satisfactory performance, also recording the experience gained from the working of these plans as a guide to possible operations." .

Billy E. Goetz, "Management control seeks to compel events to conform to plans."

Knootz and O'Donnel, "Controlling is the measurement of accomplishment against the standards and the correction of deviations to assure attainment of objectives according to plans."

Henry Fayol, "Control consists in verifying whether everything occurs in conformity, is with the plans adopted, the instructions issued and principles established. It has for its object to point out weaknesses and errors in order to rectify them and prevent recurrence."

George R. Terry, "Controlling is determining what is being accomplished, that is, evaluating the performance and if necessary, applying corrective measures so that the performance takes place according to plans."

Robert N. Anthony, "Management control is the process by which managers assure that resources are obtained and used effectively and efficiently in the accomplishment of an organisation's objectives."

Mary Cushing Niles, "Control thus viewed, is an aspect and projection of planning whereas planning sets the course to the chosen courses or to an appropriately changed one."

Haynes and Massie, "Control is any process that guides activity towards some predetermined goal. The essence of the concept is in determining whether the activity is achieving the desired results."

J.K Rosen, "Control is that function of the system which provides direction in performance to the plans."

Dalton E. Mc Farland, "The presence in a business of that force which guides it to a pre-determined objective by means of pre-determined policies and decisions."

Nature

1. Control is a Function of Management:

Actually control is a follow-up action to the other functions of management performed by managers to control the activities assigned to them in the organisation.

2. Control is based on Planning:

Control is designed to evaluate actual performance against predetermined standards set-up in the organisation. Plans serve as the standards of desired performance. Planning sets the course in the organisation and control ensures action according to the chosen course of action in the organisation.

Unless one knows what he wants to achieve in the organisation, he cannot say whether he has done right or wrong in the organisation. Control is said to be the Last step in management process but really speaking it begins with the setting up a plan in the organisation. Control implies the existence of plans or standards in the organisation.

3. Control is a Dynamic Process:

It involves continuous review of standards of performance and results in corrective action, which may lead to changes in other functions of management.

4. Information is the Guide to Control:

Control depends upon the information regarding actual performance. Accurate and timely availability of feedback is essential for effective control action. An efficient system of reporting is required for a sound control system. This requires continuing monitoring and review of operations.

5. The Essence of Control is Action:

The performance of control is achieved only when corrective action is taken on the basis of feedback information. It is only action, which adjust performance to predetermined standards whenever deviations occur. A good system of control facilities timely action so that there is minimum waste of time and energy.

6. It is a Continuous Activity:

Control is not a one-step process but a continuous process. It involves constant revision and analysis of standards resulting from the deviations between actual and planned performance.

7. Delegation is the key to Control:

An executive can take corrective action only when he has been delegated necessary authority for it. A person has authority to control these functions for which he is directly accountable. Moreover, control becomes necessary when authority is delegated because the delegator remains responsible for the duty. Control standards help a manger expand his span of management.

8. Control Aims at Future:

Control involves the comparison between actual and standards. So corrective action is designed to improve performance in future.

9. Control is a Universal Function of Management:

Control is a basic or primary function of management. Every manager has to exercise control over the subordinates' performance, no manager can get things done without the process of controlling. Once a plan becomes operational, follow-up action is required to measure progress, to uncover deficiencies and to take corrective actions.

Therefore, control is an essential managerial function at every level. The process of management is incomplete without controlling.

10. Controlling is Positive:

The function of controlling is positive. It is to make things happen i.e. to achieve the goal with instead constraints, or by means of the planned activities. Controlling should never be viewed as being negative in character.

Importance

1. Accomplishing Organisational Goals:

Controlling helps in comparing the actual performance with the predetermined standards, finding out deviation and taking corrective measures to ensure that the activities are performed according to plans. Thus, it helps in achieving organisational goals.

2. Judging Accuracy of Standards:

An efficient control system helps in judging the accuracy of standards. It further helps in reviewing & revising the standards according to the changes in the organisation and the environment.

3. Making Efficient Use of Resources:

Controlling checks the working of employees at each and every stage of operations. Hence, it ensures effective and efficient use of all resources in an organisation with minimum wastage or spoilage.

4. Improving Employee Motivation:

Employees know the standards against which their performance will be judged.

Systematic evaluation of performance and consequent rewards in the form of increment, bonus, promotion etc. motivate the employees to put in their best efforts.

5. Ensuring Order and Discipline:

Controlling ensures a close check on the activities of the employees. Hence, it helps in reducing the dishonest behaviour of the employees and in creating order and discipline in an organization.

6. Facilitating Coordination in Action:

Controlling helps in providing a common direction to the all the activities of different departments and efforts of individuals for attaining the organizational objectives.

STEPS IN CONTROL PROCESS

Control points out the deviations of the plans and suggests remedial action to improve future plans. Some of the procedures are to be found defective because of human limitations. So, control is necessary and it has the following steps:

1. Establishing standards: It is necessary to find the results which are desired. It is very useful to setting the standards. If it is not, useful control will not be possible. Standards may be quantitative or qualitative. Most of the standards are expressed in terms of quantity. Number of units produced, number of men, hours employed, total cost incurred, revenue earned, the amount of investments etc., are some of the examples of quantitative standard. If expression of standards in quantitative terms is not possible, they will be expressed in qualitative terms such as goodwill, employee's morale, motivation, etc.

The standards should have some characteristics to produce effective performance. The characteristics may be time, cost, efforts, result oriented, quantitative terms expressed, accurate, periodical revision and the like.

2. Measuring performance: The performance should be compared with the established standards. So, necessary information should be collected about the performance. The effective management information system provides the necessary information *i.e.,* performance particulars. If standards are expressed in quantitative terms, quantitative information can be collected. In other words, if standards are expressed in qualitative terms, qualitative informations can be collected. Several techniques are used by the management to measure the performance.

3. Comparison of actual with standards: Whenever the actual performance is compared with standards, the deviations are known to the management. Then, the management may find the extent of deviations and identify the reasons for deviations. Comparison is very easy when standards are expressed in terms of quantity. If results are intangible or qualitative, personal observation will be used to find out the extent of deviation.

When the actual performances are equal to the standards, there is no need for further action. Control process comes to an end with this stage. However, if the standards are not achieved, the management has to decide the type of corrective action.

All the deviations need not be reported to the management. Deviations which are beyond the reasonable limits should be reported to the top management. This is termed as control by exception or management by exception. Then, the reasons and causes for the deviations are analysed. The causes may be controllable or non-controllable. The management has to take necessary corrective action only in case the causes are controllable. However, no need will arise to the management to take corrective actions if the causes are uncontrollable.

4. Taking corrective action: Management has to find out the causes of deviation before taking corrective action. The causes of deviation may be due to ineffective and inadequate communication, defective system of wage payment, defective system of selection of personnel, lack of proper training, lack of motivation, ineffective supervisions and the like. The management has to take necessary corrective action on the basis of nature of causes of deviations.

Types of Control

1. Standardising control: Controls are used to standardise performance for increasing efficiency. Costs may be reduced by time and motion studies, inspections and work schedules.

2. Preserving control: Company assets are protected or preserved through the allocation of responsibilities. Proper accounts are maintained for assets and usage of assets are controlled and put under strict supervision.

3. Delegation of authority control: Control puts some limits to the usage or delegation of authority. The approval of the top management is necessary to use the delegation of authority. Policy manual, procedure manual and internal audits are some of the techniques included in this control.

4. Measurement control: Controls are used to measure the job performance. Performance is measured through special reports, budgets, standard cost and production per hour or per employee.

5. Motivating control: Controls are designed to motivate the employees of organisation. Motivation includes promotions, rewards for best opinions and operation, profit sharing and the like.

Techniques of Control

(A) Budgetary Control

Meaning:

Budgetary control is the process of determining various actual results with budgeted figures for the enterprise for the future period and standards set then comparing the budgeted figures with the actual performance for calculating variances, if any. First of all, budgets are prepared and then actual results are recorded.

The comparison of budgeted and actual figures will enable the management to find out discrepancies and take remedial measures at a proper time. The budgetary control is a continuous process which helps in planning and co-ordination. It provides a method of control too. A budget is a means and budgetary control is the end-result.

Definitions:

"According to Brown and Howard, "Budgetary control is a system of controlling costs which includes the preparation of budgets, coordinating the departments and establishing responsibilities, comparing actual performance with the budgeted and acting upon results to achieve maximum profitability."

Weldon characterizes budgetary control as planning in advance of the various functions of a business so that the business as a whole is controlled.

Welsch relates budgetary control with day-to-day control process." According to him, "Budgetary control involves the use of budget and budgetary reports, throughout the period to co-ordinate, evaluate and control day-to-day operations in accordance with the goals specified by the budget."

J. Betty, "Budgetary control is a system which uses budgets as a means of planning and controlling all aspects of producing and/or selling commodities or services."

R C Davis, "Budgetary control is an important means of establishing accountability for a satisfactory discharge of this responsibility for expenses. Budgetary control depends on budgetary planning."

Objectives

1. To ensure planning for future by setting up various budgets, the requirements and expected performance of the enterprise are anticipated.

2. To operate various cost centres and departments with efficiency and economy.

3. Elimination of wastes and increase in profitability.

4. To anticipate capital expenditure for future.

5. To centralise the control system.

6. Correction of deviations from the established standards.

7. Fixation of responsibility of various individuals in the organization.

8. Forecasting the financial position of the company.

9. Assisting in terms of data, the top management for policy determination.

10. Co-ordination of the work of various departments or sections of the organisation.

Advantages

The budgetary control system help in fixing the goals for the organization as whole and concerted efforts are made for its achievements. It enables 'economies in the enterprise.

Some of the advantages of budgetary control are:

1. Maximization of Profits:

The budgetary control aims at the maximization of profits of the enterprise. To achieve this aim, a proper planning and co ordination of different functions is undertaken. There is a proper control over various capital and revenue expenditures. The resources are put to the best possible use.

2. Co-ordination:

The working of different departments and sectors is properly coordinated. The budgets of different departments have a bearing on one another. The co-ordination of various executives and subordinates is necessary for achieving budgeted targets.

3. Specific Aims:

The plans, policies and goals are decided by the top management. All efforts are put together to reach the common goal, of the organization. Every department is given a target to be achieved. The efforts are directed towards achieving some specific aims. If there is no definite aim then the efforts will be wasted in pursuing different aims.

4. Tool for Measuring Performance:

By providing targets to various departments, budgetary control provides a tool for measuring managerial performance. The budgeted targets are compared to actual results and deviations are determined. The performance of each department is reported to the top management. This system enables the introduction of management by exception.

5. Economy:

The planning of expenditure will be systematic and there will be economy in spending. The finances will be put to optimum use. The benefits derived for the concern will ultimately extend to industry and then to national economy. The national resources will be used economically and wastage will be eliminated.

6. Determining Weaknesses:

The deviations in budgeted and actual performance will enable the determination of weak spots. Efforts are concentrated on those aspects where performance is less than the stipulated.

7. Corrective Action:

The management will be able to take corrective measures whenever there is a discrepancy in performance. The deviations will be regularly reported so that necessary action is taken at the earliest. In the absence of a budgetary control system the deviations can be determined only at the end of the financial period.

8. Consciousness:

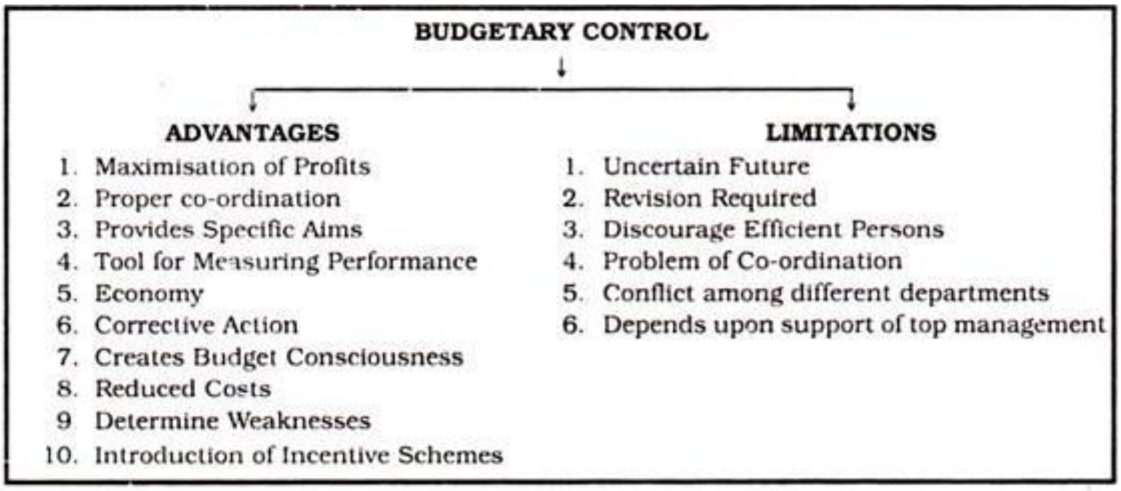
It creates budget consciousness among the employees. By fixing targets for the employees, they are made conscious of their responsibility. Everybody knows what he is expected to do and he continues with his work uninterrupted.

9. Reduced Costs:

In the present day competitive world budgetary control has a significant role to play. Every businessman tries to reduce the cost of production for increasing sales. He tries to have those combinations of products where profitability is more.

10. Introduction of Incentive Schemes:

Budgetary control system also enables the introduction of incentive schemes of remuneration. The comparison of budgeted and actual performance will enable the use of such schemes.



Limitations

1. Uncertain Future:

The budgets are prepared for the future period. Despite best estimates made for the future, the predictions may not always come true. The future is always uncertain and the situation which is presumed to prevail in future may change. The change in future conditions upsets the budgets which have to be prepared on the basis of certain assumptions. The future uncertainties reduce the utility of budgetary control system.

2. Budgetary Revision Required:

Budgets are prepared on the assumptions that certain conditions will prevail. Because of future uncertainties, assumed conditions may not prevail necessitating the revision of budgetary targets. The frequent revision of targets will reduce the value of budgets and revisions involve huge expenditures too.

3. Discourage Efficient Persons:

Under budgetary control system the targets are given to every person in the organization. The common tendency of people is to achieve the targets only. There may be some efficient persons who can exceed the targets but they will also feel contented by reaching the targets. So budgets may serve as constraints on managerial initiatives.

4. Problem of Co-ordination:

The success of budgetary control depends upon the co-ordination among different departments. The performance of one department affects the results of other departments. To overcome the problem of coordination a Budgetary Officer is needed. Every concern cannot afford to appoint a Budgetary Officer. The lack of co-ordination among different departments results in poor performance.

5. Conflict among Different Departments:

Budgetary control may lead to conflicts among functional departments. Every departmental head worries for his department goals without thinking of business goal. Every department tries to get maximum allocation of funds and this raises a conflict among different departments.

6. Depends Upon Support of Top Management:

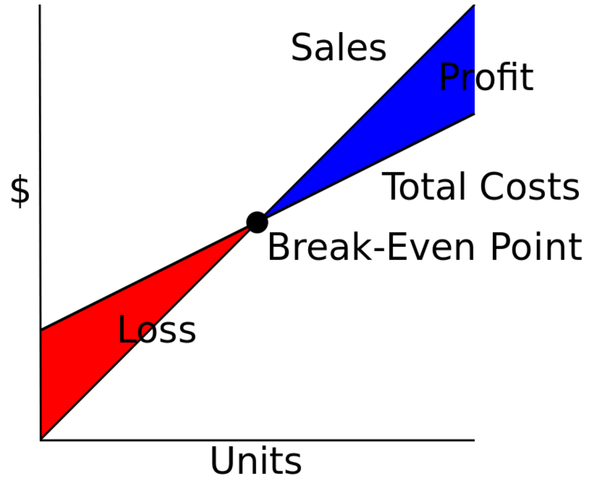
Budgetary control system depends upon the support of top management. The management should be enthusiastic for the success of this system and should give full support for it. If at any time there is a lack of support from top management then this system will collapse.

(B)Break Even Analysis

Introduction

A break-even analysis is a financial tool which helps you to determine at what stage your company, or a new service or a product, will be profitable. In other words, it’s a financial calculation for determining the number of products or services a company should sell to cover its costs (particularly fixed costs). Break-even is a situation where you are neither making money nor losing money, but all your costs have been covered.

Break-even analysis is useful in studying the relation between the variable cost, fixed cost and revenue. Generally, a company with low fixed costs will have a low break-even point of sale. For an example, a company has a fixed cost of Rs.0 (zero) will automatically have broken even upon the first sale of its product.



Meaning

Break-even point represents that volume of production where total costs equal to total sales revenue resulting into a no-profit no-loss situation.

If output of any product falls below that point there is loss; and if output exceeds that point there is profit.

Thus, it is the minimum point of production where total costs are recovered. Therefore, at break-even point.

Sales Revenue – Total Cost

Or , Sales – Variable Cost = Contribution = Fixed Cost

It can be concluded that at break-even point the contribution earned just covers the fixed cost and, at levels below the point, contribution earned is not sufficient to match the fixed cost and, at levels above the point, contribution earned more than recovers the fixed cost.

$$\text{Break-even point (units)} = \frac{\text{Fixed Cost}}{\text{Contribution per unit}}$$

$$\text{Break-even point (sales value)} = \frac{\text{Fixed Cost}}{\text{P / V ratio}}$$

Uses

(i) It helps in the determination of selling price which will give the desired profits.

(ii) It helps in the fixation of sales volume to cover a given return on capital employed.

(iii) It helps in forecasting costs and profit as a result of change in volume.

(iv) It gives suggestions for shift in sales mix.

(v) It helps in making inter-firm comparison of profitability.

(vi) It helps in determination of costs and revenue at various levels of output.

(vii) It is an aid in management decision-making (e.g., make or buy, introducing a product etc.), forecasting, long-term planning and maintaining profitability.

(viii) It reveals business strength and profit earning capacity of a concern without much difficulty and effort.

Limitations of Break-Even Analysis:

1. Break-even analysis is based on the assumption that all costs and expenses can be clearly separated into fixed and variable components. In practice, however, it may not be possible to achieve a clear-cut division of costs into fixed and variable types.

2. It assumes that fixed costs remain constant at all levels of activity. It should be noted that fixed costs tend to vary beyond a certain level of activity.

3. It assumes that variable costs vary proportionately with the volume of output. In practice, they move, no doubt, in sympathy with volume of output, but not necessarily in direct proportions..

4. The assumption that selling price remains unchanged gives a straight revenue line which may not be true. Selling price of a product depends upon certain factors like market demand and supply, competition etc., so it, too, hardly remains constant.

5. The assumption that only one product is produced or that product mix will remain unchanged is difficult to find in practice.

6. Apportionment of fixed cost over a variety of products poses a problem.

7. It assumes that the business conditions may not change which is not true.

8. It assumes that production and sales quantities are equal and there will be no change in opening and closing stock of finished product, these do not hold good in practice.

9. The break-even analysis does not take into consideration the amount of capital employed in the business. In fact, capital employed is an important determinant of the profitability of a concern.