

CHAPTER 8

CONTROLLING

Meaning of Controlling

- ✚ Controlling is the process through which management ensures that activities in an organisation are performed as per the plans.
- ✚ The controlling function finds out how far actual performance deviates from standards, analyses the causes of such deviations and attempts to take corrective actions based on the same.
- ✚ Managers at all levels of management perform controlling function to keep a control over activities in their areas.
- ✚ This process helps in formulation of future plans in the light of the problems that were identified and, thus, helps in better planning in the future periods.
- ✚ Thus, controlling only completes one cycle of management process and improves planning in the next cycle.

Importance of Controlling

Control is an indispensable function of management. Without control the best of plans can go awry. A good control system helps an organization in the following ways:

1. **Accomplishing organizational goals:** guides the organization 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 & helps to review and revise the standards in light of such changes.
3. **Making efficient use 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 reducing wastage and spoilage of resources.
4. **Improving employee motivation:** A good control system ensures that employees know the standards of performance on the basis of 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 minimize dishonest behaviour on the part of the employees by keeping a close check on their activities.
6. **Facilitating coordination in action:** Each department and employee is governed by predetermined standards which are well coordinated with one another. This ensures that overall organisational objectives are accomplished.

Limitations of Controlling

1. **Difficulty in setting quantitative standards:** Control system loses some of its effectiveness when standards cannot be defined in quantitative terms eg . Employee morale, job satisfaction and human behaviour. This makes measurement of performance and their comparison with standards a difficult task.
2. **Little control on external factors:** an enterprise cannot control external factors such as government policies, technological changes, competition etc.

3. **Resistance from employees:** 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).
4. **Costly affair:** Control is a costly affair as it involves a lot of expenditure, time and effort. 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.

Thus, planning without controlling is meaningless.

Similarly, **controlling is blind without planning.** If the standards are not set in advance, managers have nothing to control. **When there is no plan, there is no basis of controlling.**

Planning is clearly a prerequisite for controlling.

It is utterly foolish to think that controlling could be accomplished without planning.

Without planning there is no predetermined understanding of the desired performance.

Planning seeks consistent, integrated and articulated programmes while controlling seeks to compel events to 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.**

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 forwardlooking function.** On the contrary, controlling is like a postmortem of past activities to find out deviations from the standards. In that sense, **controlling is a backward-looking function.** However, it should be understood that 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** in the sense that

1. Planning based on facts makes controlling easier and effective; and
2. Controlling improves future planning by providing information derived from past experience.

Controlling Process

Controlling is a systematic process involving the following steps :-

1. Setting performance standards
2. Measurement of actual performance
3. Comparison of actual performance with standards
4. Analysing deviations
5. Taking corrective action

Step 1: Setting Performance Standards:

- ✚ The first step in the controlling process is setting up of performance standards to achieve goals.
- ✚ Standards are the criteria against which actual performance would be measured.

✚ Thus, standards serve as benchmarks towards which an organisation strives to work.

- Quantitative Standards - As far as possible, standards must be in concrete and tangible forms which will make evaluation process easy. For example, the profit expected from a particular product, time required for completing a task, cost of production for one unit is Rs.100 etc.
- Qualitative Standards - Standards can also be in intangible forms. The results expected from a training programme, loyalties of workers, Improving motivation level of employees, etc. are the examples for qualitative standards

Step 2: Measurement of Actual Performance:

- ✚ Once performance standards are set, the next step is measurement of actual performance.
- ✚ There are several techniques for measurement of performance. These include personal observation, sample checking, performance reports, etc.
- ✚ performance should be measured in the same units in which standards are set to make their comparison easier. Measurement of employee performance may require preparation of performance report by his superior.
- ✚ Measurement of a company's performance may involve ratio analysis etc., at periodic intervals.
- ✚ in large organisations, certain pieces are checked at random for quality. This is known as **sample checking**.

Step 3: Comparing Actual Performance with Standards:

- ✚ This step involves comparison of actual performance with the standard.
- ✚ 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. 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 are used for analysing deviations

1. **Critical Point Control:** 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.

Advantages of Critical Point Control and Management by Exception

When a manager sets critical points and focuses attention on significant deviations which cross the permissible limit, the following advantages accrue:

1. It saves the time and efforts of managers as they deal with only significant deviations.
 2. It focuses managerial attention on important areas. Thus, there is better utilisation of managerial talent.
 3. facilitates delegation of authority as routine problems are left to the subordinates which increases morale
 4. It identifies critical problems which need timely action to keep the organisation in right track.
2. **Management by Exception:** Management by exception, which is often referred to as control by exception, is 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.

- ✚ After identifying the deviations that demand managerial attention, these deviations need to be analysed for their causes. The deviations and their causes are then reported and corrective action taken at appropriate level.

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.
- ✚ In case the deviation cannot be corrected through managerial action, the standards may have to be revised.

Causes of deviation Corrective action to be taken

1. Defective material - Change the quality specification for the material used
2. Defective machinery - Repair the existing machine or replace the machine if it cannot be repaired
3. Obsolete machinery - Undertake technological upgradation of machinery
4. Defective process - Modify the existing process
5. Defective physical conditions of work - Improve the physical conditions of work

Techniques of Managerial Control

Traditional Techniques

- ✚ Traditional techniques are those which have been used by the companies for a long time now. However, these techniques have not become obsolete and are still being used by companies.
- ✚ These are :
 1. Personal observation
 2. Statistical reports
 3. Breakeven analysis
 4. Budgetary control

Modern Techniques

- ✚ Modern techniques of controlling are those which are of recent origin and are comparatively new in management literature. These techniques provide a refreshingly new thinking on the ways in which various aspects of an organisation can be controlled.
- ✚ These are :
 1. Return on investment
 2. Ratio analysis
 3. Responsibility accounting
 4. Management audit
 5. PERT and CPM
 6. Management information system

Traditional Techniques

1. Personal Observation

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

2. 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.

3. 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.
- ✚ It is a useful technique for the managers as it helps in estimating profits at different levels of activities.
- ✚ Breakeven analysis helps a firm in keeping a close check over its variable costs and determines the level of activity at which the firm can earn its target profit.

4. Budgetary Control

- ✚ A budget is a quantitative statement for a definite future period of time for the purpose of obtaining a given objective.
- ✚ It is also a statement which reflects the policy of that particular period. It will contain figures of forecasts both in terms of time and quantities.
- ✚ In Budgetary control all operations are planned in advance in the form of budgets and actual results are compared with budgetary standards.
- ✚ This comparison reveals the necessary actions to be taken so that organisational objectives are accomplished.

Types of Budgets

1. **Sales Budget:** A statement of what an organisation expects to sell in terms of quantity as well as value
2. **Production Budget:** A statement of what an organisation plans to produce in the budgeted period
3. **Material Budget:** A statement of estimated quantity and cost of materials required for production
4. **Cash Budget:** Anticipated cash inflows and outflows for the budgeted period
5. **Capital Budget:** Estimated spending on major long-term assets like new factory or major equipment
6. **Research and Development Budget:** Estimated spending for the development or refinement of products and processes

Budgeting offers the following advantages:

1. focuses on specific and time-bound targets and thus, helps in attainment of organisational objectives.
2. source of motivation to the employees & enables them to perform better.
3. helps in optimum utilisation of resources by allocating them as per requirement of diff departments
4. used for coordination among different departments 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 operations which deviate from budgeted standards in a significant way.

However, the effectiveness of budgeting depends on how accurately estimates have been made about future. Flexible budgets should be prepared which can be modified

8 Modern Techniques

1. Return on Investment

- ✚ Return on Investment (RoI) is a technique for measuring if invested capital has been used effectively or not for generating reasonable amount of return.

- ✚ According to this technique, RoI can be increased either by increasing sales volume proportionately more than total investment or by reducing total investment without having any reductions in sales volume.
- ✚ RoI provides top management an effective means of control for measuring and comparing performance of different departments.

2. 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:** 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:** calculated to determine the long-term solvency of business are known as solvency ratios. 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.

5. Responsibility Accounting

- ✚ Responsibility accounting is a system of accounting in which different sections, divisions and departments of an organisation are set up as 'Responsibility Centres'. The head of the centre is responsible for achieving the target set for his centre.

- ✚ Responsibility centres may be of the following types:

1. **Cost Centre** is a segment of an organisation which is responsible for the cost incurred in the centre but not for the revenues. For example, in a manufacturing organisation, production department is classified as cost centre.
2. **Revenue Centre:** a segment of an organisation which is primarily responsible for generating revenue. For example, marketing department of an organization may be classified as a revenue center.
3. **Profit Centre:** segment of an organization whose manager is responsible for both revenues and costs. For example, repair and maintenance department of an organization may be treated as a profit center if it is allowed to bill other production departments for the services provided to them.
4. **Investment Centre:** An investment centre is responsible not only for profits but also for investments made in the centre in the form of assets. The investment made in each centre is separately ascertained and return on investment is used as a basis for judging the performance of the centre.

6. Management Audit

- ✚ management audit is defined as evaluation of the functioning, performance and effectiveness of management of an organization
- ✚ The purpose is to review the efficiency and effectiveness of management and to improve its performance in future periods.
- ✚ It is helpful in identifying the deficiencies in the performance of management functions.
- ✚ The main advantages of management audit are as follows:-

1. It helps to locate present and potential deficiencies in the performance of management functions.
2. It helps to improve the control system of an organisation by continuously monitoring the performance of management.
3. It improves coordination in departments so that they work together effectively for achievement of organisational objectives.
4. It ensures updating of existing managerial policies and strategies in the light of environmental changes.

- ✚ Conducting management audit may sometimes pose a problem as there are no standard techniques of management audit. Also, management audit is not compulsory under any law.
- ✚ Enlightened managers, however, understand its usefulness in improving overall performance of the organisation.

7. PERT and CPM

- ✚ PERT (Programme Evaluation and Review Technique) and CPM (Critical Path Method)
- ✚ These techniques deal with time scheduling and resource allocation for these activities and aim at effective execution of projects within given time schedule and structure of costs.
- ✚ These techniques are especially useful for planning, scheduling and implementing time bound projects involving performance of a variety of complex, inverse and interrelated activities.

The steps involved in using PERT/CPM are as follows:

1. The project is divided into a number of clearly identifiable activities arranged in a logical sequence.
2. A network diagram is prepared to show sequence of activities, i.e. starting point & termination point
3. Time estimates are prepared for each activity. PERT requires the preparation of three time estimates – optimistic (or shortest time), pessimistic (or longest time) and most likely time. In CPM only one time estimate is prepared. CPM also requires making cost estimates for completion of project.
4. The longest path in the network is identified as the critical path. It represents the sequence of those activities which are important for timely completion of the project and where no delays can be allowed without delaying the entire project.
5. If required, the plan is modified so that execution and timely completion of project is under control. PERT and CPM are used extensively in areas like ship-building, construction projects, aircraft manufacture, etc.

8. Management Information System

- ✚ Management Information System (MIS) is a computer-based information system that provides information and support for effective managerial decision-making.
- ✚ MIS provides the required information to the managers by systematically processing a massive data generated in an organisation.
- ✚ A decision-maker requires up-to-date, accurate and timely information. Thus, MIS is an important communication tool for managers.
- ✚ MIS also serves as an important control technique so that appropriate corrective action may be taken in case of deviations from standards.

MIS offers the following advantages to the managers:

1. facilitates collection, management and dissemination of information at different levels of management and across different departments of the organisation.
2. supports planning, decision making and controlling at all levels.
3. improves the quality of information with which a manager works.
4. ensures cost effectiveness in managing information.
5. reduces information overload on the managers as only relevant information is provided to them.

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