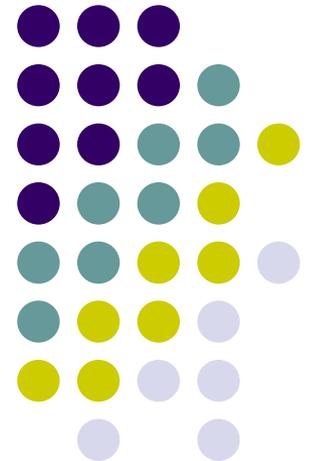
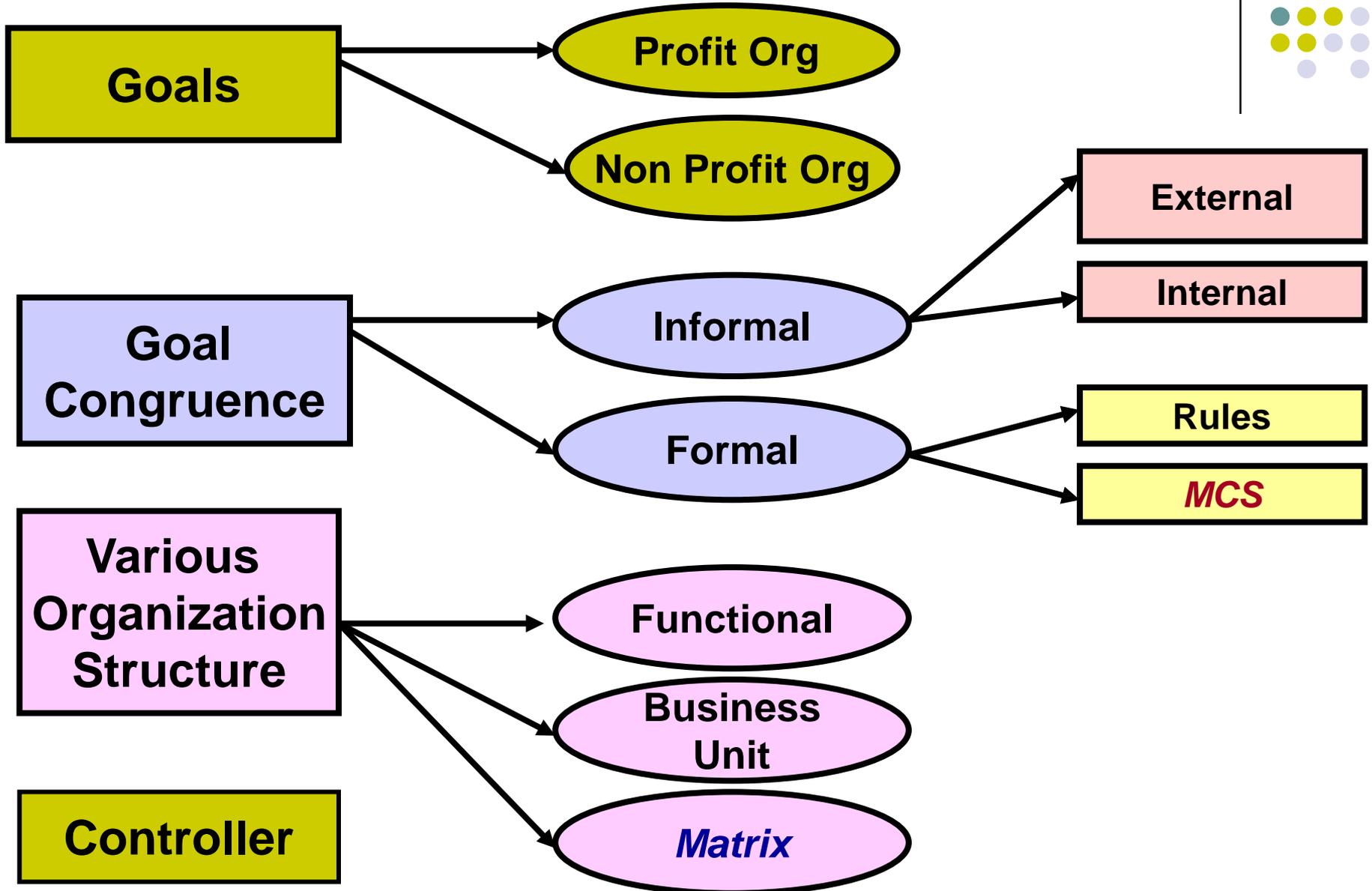
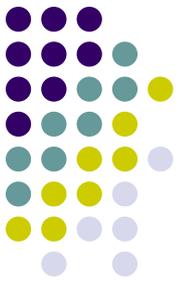


Chapter 2

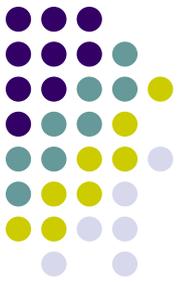
Behavior in Organizations



Mapping Ch. 2

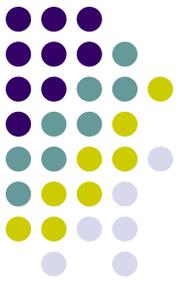


Behavior IN ORGANIZATIONS



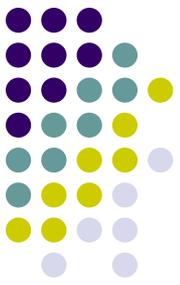
- The function of every organization is to attain its goals
- Although we often refer to the goals of a corporation, a corporation as such does not have goals. The corporation is an artificial being with no mind or decision-making ability of its own
- The goals are arrived at by the chief executive officer (CEO) of the corporation, with the advice of other members of senior management, and usually ratified by the board of directors

Goals of Profit Organization



- Profitability
 - ROI
 - “Maximizing” Shareholder Value
 - Risk
- Other Goals

ROI



- $$\frac{\text{Revenue} - \text{Expenses}}{\text{Revenue}} \times \frac{\text{Revenue}}{\text{Investment}}$$

- "Profitability" refers to profits in the long run, rather than in the current year or the current quarter; many current expenditures for advertising, research and development, and other items reduce current profits but increase long-run profits.
- Jack Welch, CEO of General Electric Company, explicitly focused on revenue; he stated that General Electric should not be in any business in which its sales revenues were not the first or second largest of any company in that business. This does not imply that he neglected the other components of the equation; rather, the implication is that if the company has the highest market share in an industry, the other elements in the equation can be satisfactorily controlled.

ROI



- Some other CEOs focus solely on revenues because they think size itself is a goal; such a focus could lead to problems. If expenses are not satisfactorily low, the profit margin will not produce a satisfactory return on the shareholders' investment. Even if the profit margin is satisfactory, the organization will not earn a satisfactory return if the amount of investment is too high.
- Some CEOs focus on profit, either as a monetary amount or as a percentage. This focus overlooks the fact that, if additional profits are obtained by a greater than proportional increase in investment, each dollar of investment has earned less than before

“Maximizing” Shareholder Value



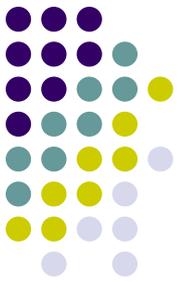
- "satisfactory profit," rather than "maximizing shareholder value," is a better way of stating a corporation's goal :
 - First, "maximizing" implies that there is a way of finding the maximum amount that a company can earn. If maximization were the goal, managers would spend every working hour (and many sleepless nights) thinking about other alternatives for increasing profitability; life is too short to warrant such an effort.

“Maximizing” Shareholder Value



- Although optimizing shareholder value may be one goal, it is by no means the only goal in most organizations. Most managers want to behave ethically, and most feel an obligation to other stakeholders in the organization. It is unrealistic to argue that a business has only one constituency, namely, shareholders, and therefore, only one responsibility, namely, economic performance.
- Shareholder value is usually equated with the market value of the company's stock; but market value is not an accurate measure of what the shareholders' investment is actually worth, except at the moment at which the shares are traded. Today's stock price results from the judgment of the *average* investor; but the average investor tends to think primarily about the company's prospects in the short run, whereas share-holders should want management to make decisions that benefit the corporation in the long run, even at the expense of short-run profitability.

Example



- Henry Ford's operating philosophy was satisfactory profit, not maximum profit. To quote Ford, "And let me say right here that I do not believe that we should make such an awful profit on our cars. A reasonable profit is right, but not too much. So it has been my policy to force the price of the car down as fast as production would permit, and give the benefits to the users and laborers-with resulting surprisingly enormous benefits to ourselves."

RISK

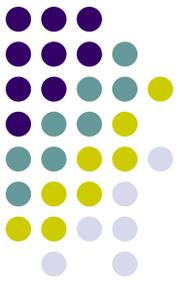


- An organization's pursuit of profitability is affected by management's willingness to take risks. The acceptable degree of risk taking varies with the personalities of individual managers. Nevertheless, there is an upper limit. In some organizations, there is an explicit statement to the effect that management's primary responsibility is to preserve the company's assets and that the goal of profitability is subordinate to this. The calamitous bankruptcy of hundreds of savings and loan associations in the 1980s is traceable, in large part, to managements that made what appeared to be highly profitable loans without giving adequate recognition to riskiness of those loans.

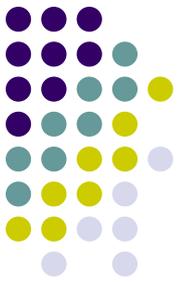
Other Goals

A survey by Posner and Schmidt of 900 American executives

1. organizational effectiveness,
2. high productivity,
3. good organizational leadership,
4. high morale,
5. good organizational reputation,
6. high organizational efficiency,
7. *profit maximization*,
8. organizational growth,
9. organizational stability,
10. value to lo-cal community, and
11. service to the public

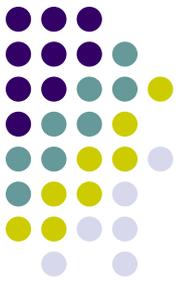


Rank of Stakeholders



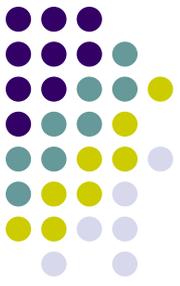
1. Customers
2. "myself,"
3. subordinates,
4. employees as a whole,
5. bosses,
6. coworkers and colleagues,
7. managers,
8. technical and white-collar employees,
9. founders of the company,
10. crafts-men and skilled workers,
11. public *stockholders*,
12. elected public officials and government bureaucrats

Goals of Non-Profit Organization

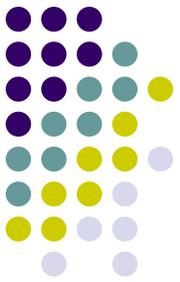


- To provide service
- Financial goal
 - rainy days
 - Source of fund

Goal Congruence



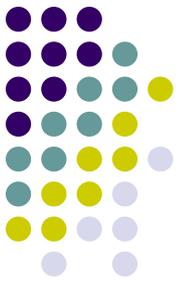
- **Goal congruence in a process means that actions which it leads people to take in accordance with their perceived self-interest are also in the best interest of the organization.**
- **Perfect congruence between individual goals and organizational goals does not exist**
- **As a minimum, however, the management control system should not encourage individuals to act against the best interests of the organization**



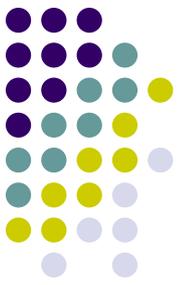
Goal Congruence

- Informal Factors
 - External factors
 - Internal factors
- Formal Factors
 - Rules
 - MCS

External Factors



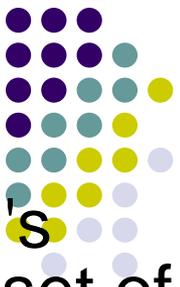
- External factors are norms of desirable behavior that exist in the society of which the organization is a part.
- They are often referred to as the *work ethic*
- They are manifest in employees' loyalty to the organization, their diligence, their spirit, and their pride in doing a good job (as contrasted with merely putting in time.)



Example

- Many large Japanese companies go to great lengths to instill loyalty. They have company pep songs. They support baseball teams that compete regionally and nationally. The teams are accompanied by cheerleaders (with cheers specific to the company) and marching bands. These activities are similar to those that instill loyalty in students at an American college or university. Employees dress in the company uniform.

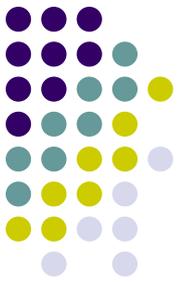
Internal Factors



Culture

- The most important internal factor is the organization's culture, or climate. Organization culture refers to the set of common beliefs, attitudes, norms, relationships, and assumptions that are explicitly or implicitly accepted and evidenced throughout the organization
- A company's culture exists unchanged for many years. Certain practices are rituals; they are carried on almost automatically because "this is the way things are done here." Others are taboos; "we just don't do that here," although no one remembers why.
- Culture is influenced strongly by the personality and policies of the chief executive officer (and by those of lower-level managers with respect to the part of the organization that they manage)
- Attempts to change practices meet resistance; and, the larger and more mature the organization, the greater the resistance is.

Internal Factors



Management Style

- Usually the attitude of subordinates reflects in a general way their perception of the attitude of their superiors, modified, of course, by the subordinate's own attitude. The attitude ultimately stems from the attitude of the chief executive officer. This is another way of saying "an institution is the lengthened shadow of a man."
- Managers come in all shapes and sizes. Some are charismatic and outgoing; others are less ebullient. Some spend much time looking and talking to people (called "management by walking around"); others rely more heavily on written reports. We know of no way of generalizing about the "ideal" manager

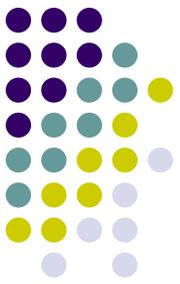
Internal Factors



The Informal Organization

- The lines on an organization chart depict the formal organization-that is, the formal authority and responsibility relationships of the specified managers. The organization chart may show, for example, that the production manager of Division A reports to the general manager. Actually the production manager communicates with several other people in the organization: other managers, support units, and staff people at headquarters-and simply friends and acquaintances.
- In extreme situations, the production manager may pay inadequate attention to messages received from the general manager. This tends to happen when the production manager is evaluated more on production efficiency than on overall performance. The relationships that constitute the informal organization are important in understanding the realities of the management control process.

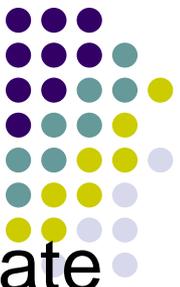
Internal Factors



- Perception and Communication

In working toward the goals of the organization, operating managers must know what these goals are and what actions they are supposed to take in order to achieve them. They receive information through various channels about what they are supposed to do. In part this information is conveyed by budgets and other formal documents; in part it is conveyed by conversations and other informal means. This information often is not a clear and unambiguous message about what senior management wants done.

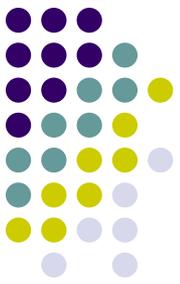
Internal Factors



Cooperation and Conflict

- An organization attempts to maintain an appropriate balance between the forces that create conflict and those that create cooperation. Some conflict is desirable. Conflict results in part from the competition among participants for promotion or other forms of compensation; such competition is, within limits, healthy. A certain amount of cooperation is also obviously essential; but if undue emphasis is placed on developing cooperative attitudes, the most able participants will be denied the opportunity of using their talents fully. The management control system must help to maintain the appropriate balance between conflict and cooperation within the organization.

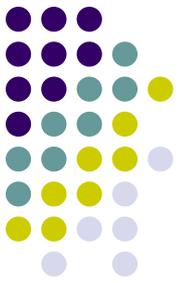
Formal Control System



- MCS
- Rules

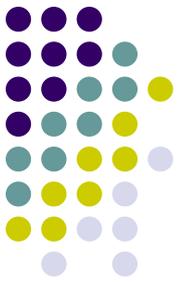
All types of formal instructions and controls. They include standing instructions, practices, job descriptions, standard operating procedures, manuals, and codes of ethics. Unlike the directives or guidance implicit in budget amounts, which change from month to month, these rules are in force indefinitely-that is, they exist until they are modified. Typically rules are changed infrequently. They relate to matters that range from the most trivial (e.g., paper clips will be issued only on the basis of a signed requisition) to the most important (e.g., capital expenditures of over \$5 million must be approved by the board of directors).

Formal Control System



Rules

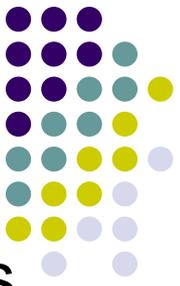
- *Physical controls*
- *Manuals*
- *System safeguards*
- *Task control systems*



Physical controls

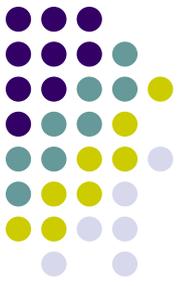
- Security guards, locked storerooms, vaults, computer passwords, television surveillance, and other physical controls are part of the control structure. Most of them are associated with task control, rather than with management control.

Manuals

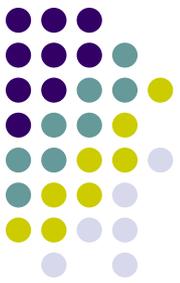


- Much judgment is required in deciding which rules should be written and put in a manual; which should be guidelines, rather than fixed rules; what discretion should be allowed; and a variety of other matters. The literature contains only obvious guidance on these matters. Bureaucratic organizations have more detailed manuals than other organizations; large organizations have more than small ones; centralized organizations have more than decentralized ones; and organizations with geographically dispersed units performing similar functions (such as fast-food restaurant chains) have more rules than single-site organizations.

System safeguards



- Various safeguards are built into the information processing system to ensure that the information flowing through the system is accurate and to prevent (or at least minimize) fraud and defalcation. They include cross-checks of totals with details, required signatures and other evidence that a transaction has been authorized, separation of duties, frequent counts of cash and other portable assets, and a number of other rules that are described in texts on auditing. They also include checks of the system that are made by the internal auditors and the external auditors.



Task control systems

- In Chapter 1 we defined task control as the process of assuring that specific tasks are carried out efficiently and effectively. Many of these tasks are controlled by rules. If a task is automated, the automated system itself provides the control. Task control systems are outside the scope of this book.

Formal Control Process

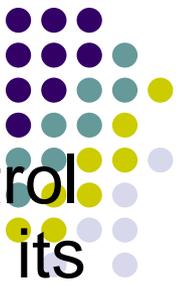
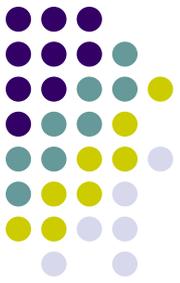


Exhibit 2-1 is a sketch of the formal management control process. Its foundation is the organization's goals and its strategies for attaining these goals. A strategic plan is prepared in order to implement these strategies; all available information is used in making this plan. The strategic plan is converted to an annual budget that focuses on the planned revenues and expenses for individual responsibility centers. Responsibility centers also are guided by a large number of rules. They operate, and the results of their operation are measured and reported. Actual results are compared with the plan, to answer the question "was performance satisfactory?" If it was satisfactory, there is feedback to the responsibility center in the form of praise or other reward. If performance was not satisfactory, there is feedback leading to corrective action in the responsibility center and possible revision of the plan.

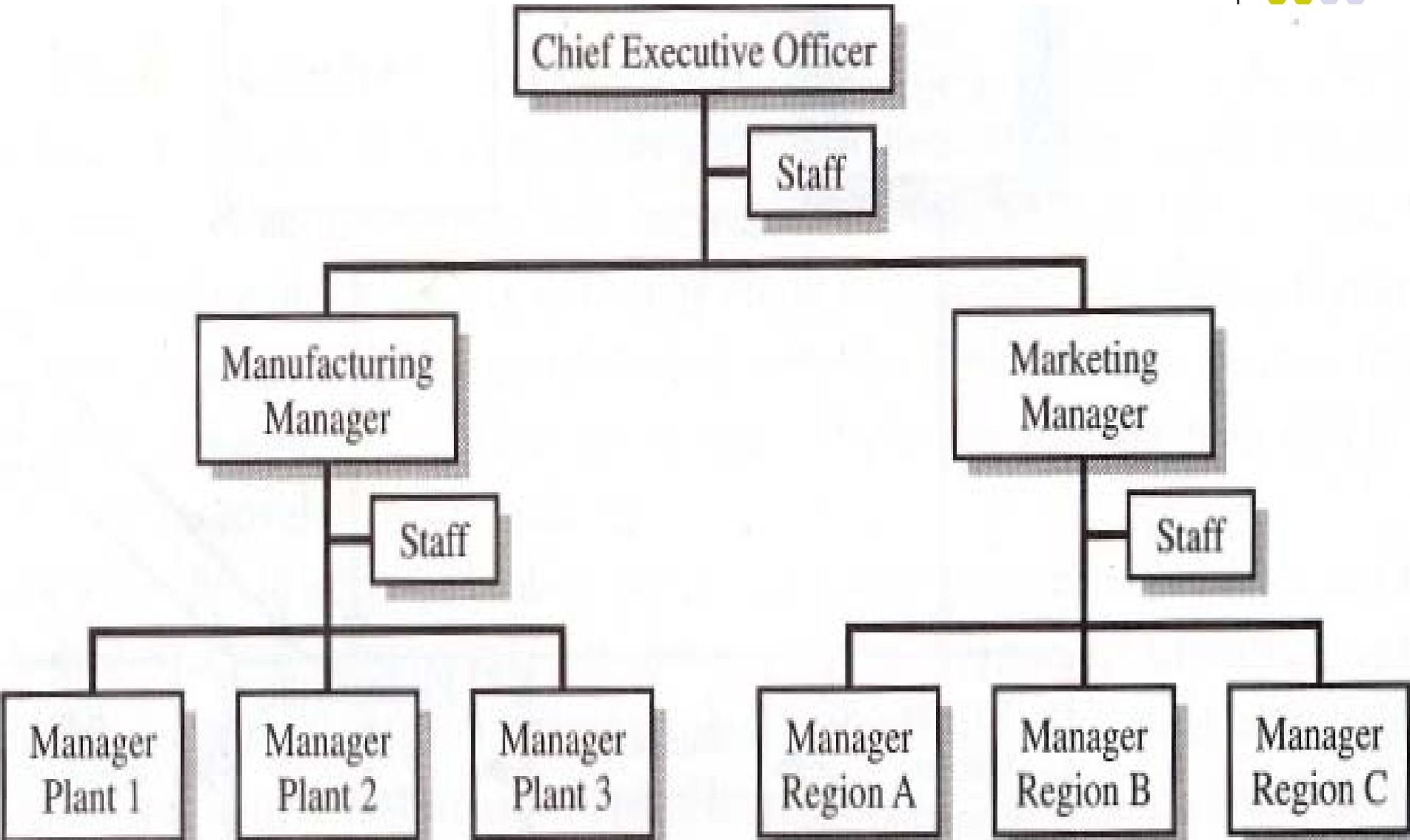
Types of Organization



The firm's strategy has an important influence on its organization structure. The type of organization structure, in turn, has an influence on the design of management control systems

- **Functional Organizations**
- **Business Unit**

Functional Organizations



Functional Organizations



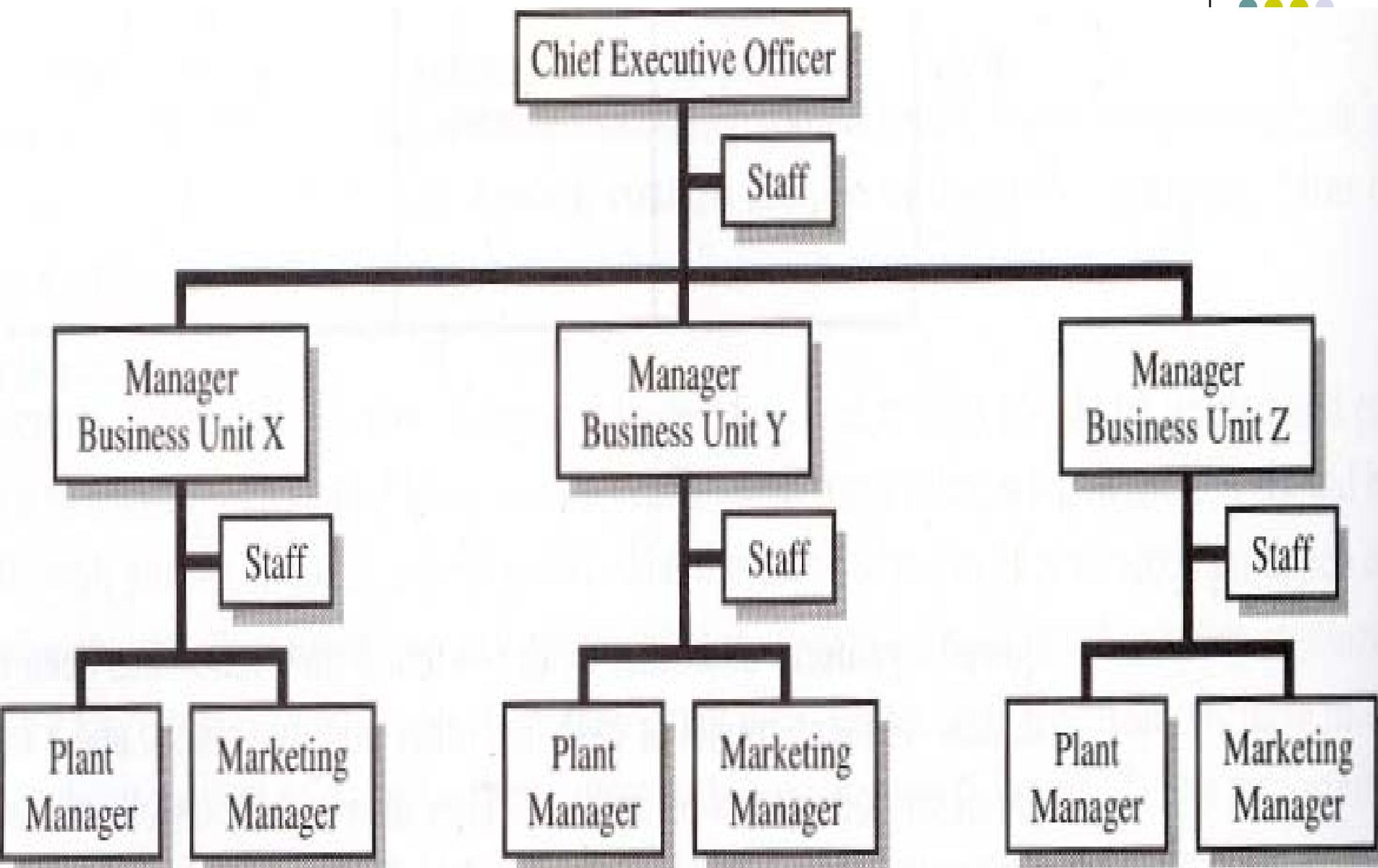
- It involves the notion of a manager who brings specialized knowledge to bear on decisions related to the function.
- A skilled marketing manager should make better marketing decisions and a skilled production manager should make better production decisions than the decisions made by a manager who is responsible for both marketing and production. Moreover, the skilled specialist should be able to supervise workers in the same function better than the generalist; similarly, skilled higher-level managers should be able to provide better supervision of lower-level managers in the same or similar function.
- *an important advantage of a functional structure is efficiency.*

Functional Organizations



- A disadvantage of the functional organization is that there is no unambiguous way of determining the effectiveness of the separate functional managers because each function contributes jointly to the final output of the organization.
- Another disadvantage of the functional organization is that there is no good way of planning the work of the separate functions at lower levels in the organization.
- a dispute between managers of different functions can be resolved only at the very top of the organization, even though it originates at a low level (time consuming and frustrating)

Business Unit

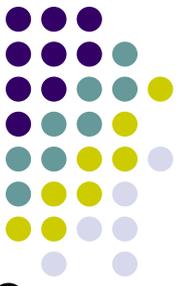


Business Unit

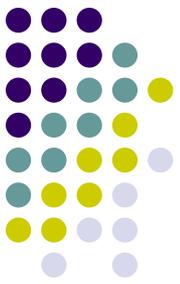


- The business unit form of organization is designed to solve problems inherent in the functional structure. A business unit (also called a "division") is responsible for all the functions involved in producing and marketing a specified product line. Business unit managers act almost as if their units were separate companies. They are responsible for planning and co-ordinating the work of the separate functions, and they resolve disputes that arise between these functions. They ensure that the plans of the marketing department are consistent with production capabilities. Their performance is measured by the profitability of the business unit, and this is a satisfactory measure because profit incorporates the activities of both marketing and production.

Business Unit

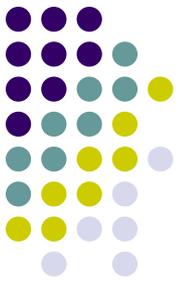


- Business unit managers do not have complete authority. Headquarters reserves the right to make certain decisions. As a minimum, headquarters is responsible for obtaining funds for the company as a whole, and it allocates funds to business units according to its judgment on where the available funds can be put to the best use. Headquarters also approves the business unit budgets, judges the performance of business unit managers, sets their compensation, and if the situation warrants, removes them. Headquarters establishes the "charter" of each business unit—that is, the product lines it is permitted to make and sell or the geographical territory in which it can operate, or both, and occasionally, the customers that it may sell to.

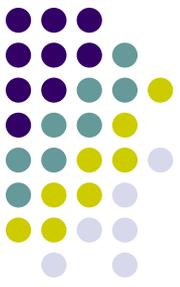


- Headquarters also establishes companywide policies. Depending on the wishes of the chief executive officer, these may be few and general, or they may be set forth in several thick volumes of manuals. Headquarters staff offices may assist the business units in production and marketing activities and in specialized areas, such as human resources, legal, public relations, controller, and treasury. These headquarters functions are valuable. If this were not the case, the business units would be better off being separate companies.

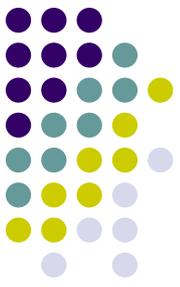
Business Unit



- An advantage of the business unit form of organization is that it provides a training ground in general management. The business unit manager should have the entrepreneurial spirit that characterizes the CEO of an independent company.
- Another advantage is that the business unit, being closer to the market for its products than the headquarters organization, may make sounder decisions than headquarters can make and can react to new threats or opportunities more quickly.



- Offsetting these advantages is the possibility that each business unit staff may duplicate some work that in a functional organization is done at headquarters. The business unit manager is presumably a generalist, but his or her subordinates are functional specialists, and they must deal with many of the same problems that specialists in other business units and at headquarters address. The layers of business unit staff may be more expensive than the value gained by divisionalization. Moreover skilled specialists in certain functions are in short supply, and business units may be unable to attract qualified persons.



- Additionally the disputes between functional specialists in a functional organization may be replaced by disputes between business units in a business unit organization. These may involve one business unit infringing on the charter of another unit. There may also be disputes between business unit staffs and headquarter's staff.
- Although the possibility of holding several managers responsible for pieces of the company's overall profit performance is attractive, these disadvantages may outweigh the benefits of business unit structure. Business units are profit centers or investment centers, and further discussion of the merits and disadvantages of business unit structure in various circumstances is deferred to Chapters 4 and 6, which deal with these responsibility centers.

Implications for Systems Design



- If ease of control were the only criterion, companies would be organized into business units whenever it was feasible to do so because in a business unit organization, each unit manager is held responsible for the profitability of the unit's product line, and he or she presumably plans, coordinates, and controls the elements that affect its profitability. Control is not the only criterion, however. A functional organization may be more efficient because larger functional units provide the benefits of economies of scale. A business unit organization requires a somewhat broader type of manager than the specialist who manages a function; competent general managers may be difficult to find.



- Because of the apparently clear-cut nature of the assignment of profit responsibility in a business unit organization, designers of management control systems sometimes recommend such an organization without giving appropriate weight to the other considerations involved in organization design. Finally the systems designer must fit the system to the organization, not the other way around. In other words, although the control implications of various organization structures should be discussed with senior management, once management has decided that a given structure is best, all things considered, then the system designer must take that structure as given. Enthusiasts for some control technique may over-look this essential point.



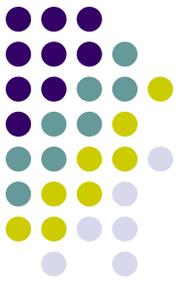
- The point also is important in other contexts. For example, many advertising agencies follow the practice of shifting account supervisors from one account to another at fairly frequent intervals and so bring a fresh point of view to the various advertising programs. This practice increases the difficulty of measuring the performance of an account supervisor because the fruits of an advertising campaign may require a long time to ripen. Nevertheless, the systems designer should not insist that the rotation policy be abandoned simply because to do so would make performance measurement easier.

Functions of the Controller

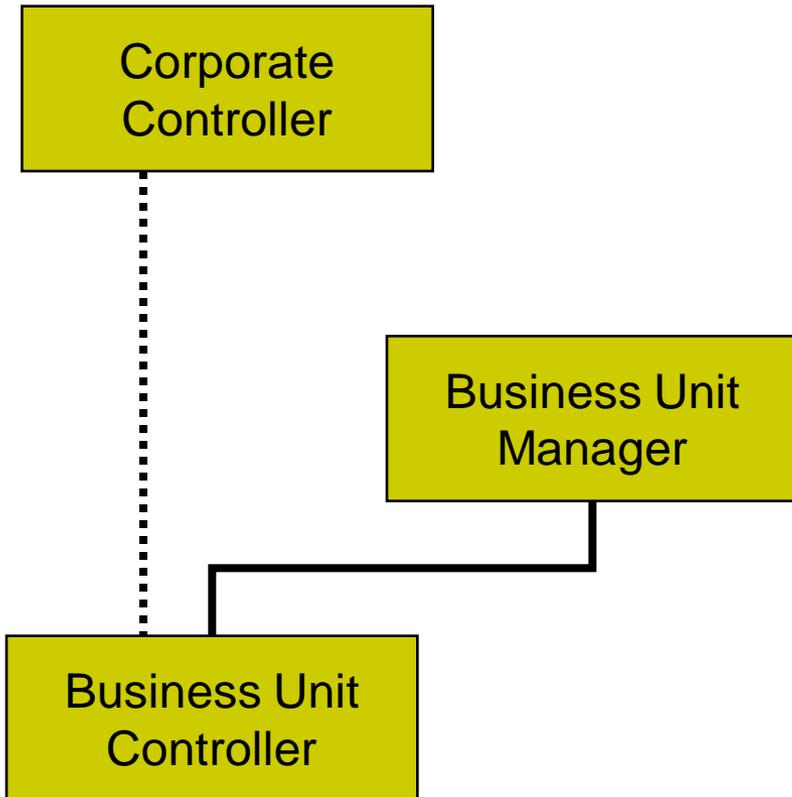


- Designs and operates information and control systems
- Prepares financial statements and financial reports (including tax returns) to shareholders and other external parties.
- Prepares and analyzes performance reports and assists managers by interpreting these reports, by analyzing program and budget proposals, and by consolidating the plans of various segments into an overall annual budget."
- Supervises internal audit and accounting control procedures to ensure the validity of information, establishes adequate safeguards against theft and defalcation, and performs operational audits.
- Develops personnel in the controller organization and participates in the education of management personnel in matters relating to the controller function.

Controller



Dotted Line



Solid Line

