Chapter 7

Organizational Control

CHAPTER OUTLINE

I. WHAT IS ORGANIZATIONAL CONTROL?
   A. Controlling is the process whereby managers monitor and regulate how efficiently and effectively an organization and its members are performing the activities necessary to achieve organizational goals.
      1. In controlling, managers monitor and evaluate whether their organization’s strategy and structure are working as intended, how they could be improved, and how they might be changed if they are not working.
      2. Control involves keeping an organization on track and anticipating events that might occur.
      3. It is also involved with keeping employees motivated, focused upon important problems facing the organization, and working together to take advantage of opportunities.

   B. The Importance of Organizational Control: A control system contains the measures or yardsticks that allow managers to assess how efficiently the organization is producing goods and services.
      1. Without a control system in place, managers have no idea how their organization is performing and how its performance can be improved.
      2. Organizational control is important in determining the quality of goods and services because it gives managers feedback on product quality.
      3. Effective managers create a control system that consistently monitors the quality of goods and services so that they can make continuous improvements to quality.
      4. By developing a control system to evaluate how well customer-contact employees are performing their jobs, managers can make their organizations more responsive to customers.
      5. Monitoring employee behavior can help managers find ways to increase employees’ performance levels.
      6. Controlling can raise the level of innovation in an organization by deciding on the appropriate control systems to encourage risk taking.
C. Control Systems and IT: Control systems are formal target-setting, monitoring, evaluation, and feedback systems that provide managers with information about whether the organization’s strategy and structure are working efficiently and effectively.

1. An effective control system has three characteristics:
   a. it is flexible enough to allow managers to respond as necessary to unexpected events
   b. it provides accurate information
   c. it provides managers with the information in a timely manner.

2. New forms of IT have revolutionized control systems because they facilitate the flow of accurate and timely information up and down the organizational hierarchy and between functions and divisions.

3. Control systems are developed to measure performance at each stage in the conversion of inputs into finished goods and services.
   a. At the input stage, managers use feed-forward control to anticipate problems before they arise so that problems do not occur later, during the conversion process.
      i. At this stage, IT can be used to keep in contact with suppliers, monitor their progress, and control the quality of inputs received from them.
   b. At the conversion stage, concurrent control gives managers immediate feedback on how efficiently inputs are being transformed into outputs.
      i. Concurrent control through IT alerts managers to the need to react quickly to the source of the problem.
      ii. Concurrent control is at the heart of total quality management programs.
   c. At the output stage, managers use feedback control to provide information about customers’ reactions to goods and services so that corrective action can be taken if necessary.

D. The Control Process: The control system, whether at the input, conversion, or output stage, can be broken down into four steps. They are:

1. Step 1: Establish the standard of performance, goals, or targets against which performance is to be evaluated.
   a. The standards performance that managers select measure efficiency, quality, responsiveness to customers, and innovation.
   b. Performance standards selected at one level affect those at the other levels, and ultimately the performance of individual managers is evaluated in terms of their ability to reduce costs.

2. Step 2: Measure actual performance. Managers can measure or evaluate two things:
   a. the actual outputs that result from the behavior of their members
   b. the behaviors themselves (hence the terms output control and behavior control).
c. In general, the more non-routine or complex organizational activities are, the harder it is for managers to measure outputs or behaviors.
d. Outputs, however, are usually easier to measure than behaviors because they are more tangible and objective.

4. Step 4: Evaluate the result and initiate corrective action if the standard is not being achieved.

II. OUTPUT CONTROL:
A. All managers develop a system of output control for their organizations. The three main mechanisms that managers use to assess output or performance are financial measures, organizational goals, and operating budgets.

B. Financial Measures of Performance: Top managers use various financial measures to evaluate performance. The most common financial measures are:
1. Profit ratios, which measure how efficiently managers are using the organization’s resources to generate profits.
2. Return on investment (ROI), which is an organization’s net income before taxes divided by its total assets, is the most commonly used financial profit ratio.
3. Gross profit margin is the difference between the amount of revenue generated and the resources used to produce the product.
   a. It provides information about how efficiently an organization is using its resources.
   b. Both of these profit ratios allow managers to assess its competitive advantage.
4. Liquidity ratios measure how well managers have protected organizational resources so as to be able to meet short-term obligations.
   a. The current ratio (current assets divided by current liabilities) tells managers whether they have the resources to meet claims for short-term creditors.
   b. The quick ratio tells whether they can pay these claims without selling inventory.
5. Leverage ratios such as the debt-to-assets ratio and the times-covered ratio measure the degrees to which managers use debt or equity to finance ongoing operations.
6. Activity ratios provide measures of how well managers are creating value from assets.
   a. Inventory turnover measures how efficiently managers are turning over inventory.
   b. Days sales outstanding provide information on how efficiently managers are collecting revenue from customers.
7. Financial information informs managers about the results of past decisions, but does not tell them how to find new opportunities to build competitive advantage in the future. To encourage a future oriented approach, organizational goals are needed.

C. Organizational Goals: After top managers have set the organization's overall goals, they then establish performance standards for the various divisions and functions.
   1. These standards specify for divisional and functional managers the level at which their units must perform if the organization is to achieve its overall goals.
   2. Divisional managers then develop a business-level strategy that they hope will allow them to achieve that goal.
   3. In consultation with functional managers, they specify the functional goals that managers of different functions need to achieve to allow the division to achieve its goals.
   4. In turn, functional managers establish goals that first-line managers and non-managerial employees need to achieve to allow the function to achieve its goals.
   5. It is vital that the goals set at each level harmonize with the goals set at other levels.
   6. Also, goals should be set appropriately so that managers are motivated to accomplish them.
   7. The best goals are specific, difficult goals that will challenge and managers’ ability but are not out of reach.

D. Operating Budgets: The next step in developing an output control system is to establish operating budgets.
   1. An operating budget is a blueprint that states how managers intend to use organizational resources to achieve organizational goals efficiently.
   2. Managers at one level allocate to subordinate managers a specific amount of resources to use to produce goods and services.
   3. These lower-level managers are evaluated on their ability to stay within the budget and to make the best use of resources.
   4. Large organizations often treat each division as a stand-alone responsibility center, and then evaluate each division’s contribution to corporate performance.
      a. Managers of a division may be given a fixed budget and evaluated for the amount of goods or services they can produce from it (a cost or expense budget approach.)
      b. Or managers may be asked to maximize the revenues from the sales of goods and services produced (a revenue budget approach.)
c. Or they may be evaluated on the difference between the revenues generated and the budgeted cost of making those goods and services (a profit budget approach.)

E. Problems with Output Control:
1. When designing an output control system, managers must be sure that the output standards they create motivate managers at all levels and do not encourage inappropriate behavior as a way to achieve organizational goals.
2. A manager’s primary concern should be long-term effectiveness.
   a. Therefore, if conditions change, it is probably better that top managers communicate to those lower in the hierarchy that they are aware of the changes taking place and are willing to revise and lower goals and standards.
   b. Managers must be sensitive to how they use output control and constantly monitor its effects at all levels in the organization. Output controls should serve as a guide to appropriate action.

III. BEHAVIOR CONTROL:
A. Behavior control, along with output control, is a method of motivating employees. There are three mechanisms of behavior control that managers can use: direct supervision, management by objectives, and rules and standard operating procedures.

B. Direct Supervision: The most immediate and potent form of behavior control is direct supervision by managers.
   1. Under direct supervision, managers actively monitor and observe, teach, and correct subordinates.
   2. When managers personally supervise subordinates, they lead by example and in that way, help subordinates develop and increase their own skills.
   3. Problems are associated with direct supervision include:
      a. It is very expensive because a manager can personally manage only a small number of subordinates effectively.
         i. For this reason, output control is usually preferred over behavior control.
      b. Direct supervision can demotivate subordinates if they feel that they are not free to make their own decisions.
      c. For many jobs direct supervision is not feasible.
         i. The more complex a job, the more difficult it is for a manager to determine how well an employee is performing.

C. Management by Objectives: To provide a framework within which to evaluate subordinates’ behavior, many organizations implement some version of management by objectives (MBO).
1. Management by objectives is a system of evaluating subordinates for their ability to achieve specific organizational goals or performance standards and to meet operating budgets. It involves three steps.
   a. Step 1: Specific goals and objectives are established at each level of the organization.
   b. Step 2: Managers and their subordinates together determine the subordinates’ goals.
   c. Step 3: Managers and their subordinates periodically review the subordinates’ progress toward meeting goals.

2. In companies in which responsibilities have been decentralized to empowered teams, MBO works somewhat differently.
   a. Managers as each team to develop a set of goals and performance targets that the team hopes to achieve.
   b. Managers then negotiate with each team to establish its final goals and the budget the team will need to achieve them.
   c. Rewards are linked to team performance, not to the performance of any one team member.

D. Bureaucratic Control: When direct supervision is too expensive and MBO is inappropriate, managers may use bureaucratic control.
   1. Bureaucratic control is control of behavior by means of a comprehensive system of rules and standard operating procedures (SOPs) that shape and regulate the behavior of divisions, functions, and individuals.
      a. Rules and SOPs guide behavior and specify what employees are to do when they confront a problem.
         i. It is the responsibility of a manager to develop rules that allow employees to perform their activities efficiently and effectively.
      b. When employees follow the rules, their behavior is standardized—actions are performed in the same way time and time again.
         i. There is no need to monitor the outputs of behavior because standardized behavior leads to standardized outputs.

2. Problems with Bureaucratic Control:
   a. With a bureaucratic control system in place, managers can manage by exception and intervene and take corrective action only necessary.
   b. However, the following problems have been associated with bureaucratic control, which can reduce organizational effectiveness. They are:
      i. Establishing rules is always easier than discarding them. If the amount of “red tape” becomes onerous, sluggishness can imperil an organization’s survival.
      ii. Because rules constrain and standardize behavior, there is a danger that people become so used to automatically following rules that they stop thinking for themselves.
      iii. Innovation is incompatible with the use of extensive bureaucratic control.
c. Bureaucratic control is most useful when organizational activities are routine and when employees are making programmed decisions.
   i. It is less useful where nonprogrammed decisions have to be made and managers have to react quickly to changes.

E. For many of the most significant organizational activities, output control and behavior control are inappropriate, for the following reasons:
   1. A manager cannot evaluate the performance of workers such as doctors, research scientists, or engineers by observing their behavior on a day-to-day basis.
   2. Rules and SOPs are of little use in telling a doctor how to respond to an emergency situation or a scientist how to discover something new.
   3. Output controls such as the amount of time a surgeon takes for each operation or the costs of making a discovery are very crude measure of the quality of performance.

IV. CLAN CONTROL
   A. Clan control takes advantage of the power of internalized values and norms to guide and constrain employee attitudes and behavior in ways that increase organizational performance.

   B. Clan control serves the dual function of keeping organizational members goal directed while also open to new opportunities because it takes advantage of the power of organizational culture.

   C. Organizational culture functions as a kind of control system because managers can deliberately try to influence the kind of values and norms that develop in an organization – values and norms that specify appropriate and inappropriate behaviors and so determine the way its members behave.