CONTROLLING

Meaning

Controlling is the process through which management ensures that the actual performance conforms to the planned performance. It discovers deviation from the results expected. It also identifies the reasons for deviations and suggests suitable action to avoid their recurrence in future.

Controlling Process (Steps in Controlling)

1. Setting Standards
2. Measurement of Actual Performance
3. Comparison of Actual Performance
4. Analyzing Deviations
5. Taking Corrective Actions

1. **Setting performance Standards –** In order to achieve the goals, standards of performance have to be determined in planning itself.

   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.

2. **Measurement of actual performance –** The second step is to measure actual performance of employees or departments. It should measure actual performance of each activity in terms of quality and quantity.
3. **Comparison of actual performance with standards –** Comparison of actual performance with the standards reveals the deviations between actual and desired results.
4. **Analyzing deviations –** At this stage, the extent of deviations and causes of such deviations are to be found out. It is important to ascertain whether deviations are within the expected range. Deviations in key areas of business require urgent attention. Managers can rely on the following in this regard.
   a. **Critical Point Control –** The control measures should be focused on key result areas (KRAs) which are critical in the success of an organization. These KRAs are the Critical Points, if anything goes wrong at this critical point, the entire organization will suffer. Example: 5% increase in labour cost is a serious matter than 20% increase in postal charges.
   b. **Management by Exception (MBE) / Control by Exception -** All deviations need not be brought to the attention of top management. Only those deviations which seem

exceptionally high and which cannot be easily solved by lower level management alone should be reported to top management. Example: 2% increase in the material cost (if it is within the permissible limit) need not be reported, whereas, if it is far beyond the limit, say 10% increase, it requires immediate attention of management on a priority basis. In other words, the top level management is concerned with highly exceptional matters only and the routine matters will be handled by the lower levels.

5. **Taking corrective actions –** As soon as deviations are reported, it is the duty of the executives to take steps to correct the past action so that deviations may not occur again and the plans are properly executed. If there is no deviation or if the deviation is within the permissible limit, let the situation remains as it is.

   At times, the deviations may be such that which cannot be rectified and beyond the control of management, they may take necessary decisions by modifying the goals and standards.

   Some examples for corrective action:

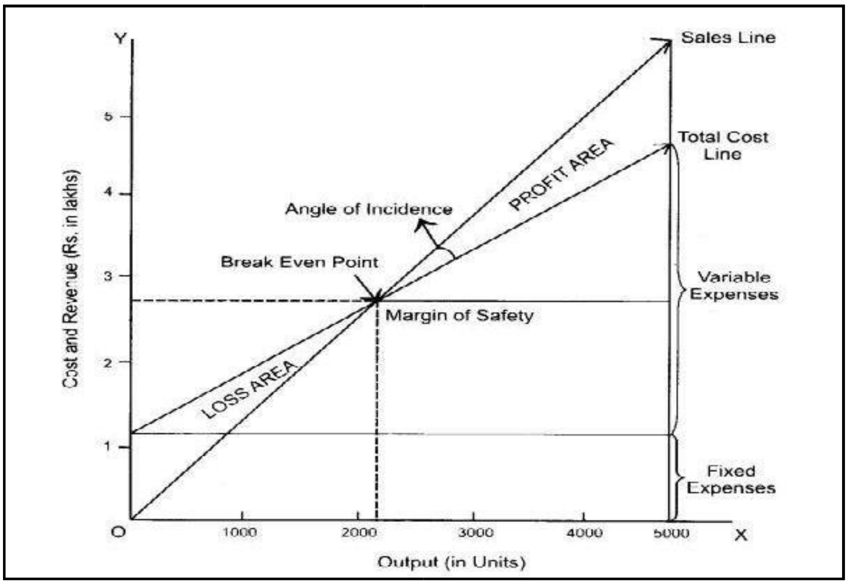
Cause of deviation	Corrective action to be taken
Defective material	Change the supplier or quality
Defective machinery	Repair or replace
Obsolete machinery	Undertake technological up gradation
Increase in labour turnover	Improve working conditions and provide better incentives
Defective process	Modify the existing process

Techniques of managerial control A. Traditional Techniques

1. **Personal observation –** Personal observation on the employee may create a psychological pressure to perform well.

2. **Statistical reports –** Statistical information regarding performance of employees in the form of charts, graphs, tables etc. enable the managers to interpret them and to make comparison.

3. **Break-even analysis -** The level of operation where total revenue or sales are equal to total cost is called the break-even point. At this point (sales volume) the firm makes no profit or no loss.



4. **Budgetary control –** It is a technique of controlling the activities of an organization with the help of budgets. It involves the comparison of actual performance with the budgetary standards. In case of deviations the firm can take necessary corrective actions. E.g. Sales budget, production budget, Materials budget (raw material utilization), Purchase budget, cash budget (estimated receipts and payments), capital budget, research and development budget etc.

Advantages of budgetary control

1. Budget is a guidance for management in planning and policy formulation.
2. Gives a direction to the organisation by fixing the goals and targets.
3. Minimises wastages and losses.
4. Actual performance can be compared with budgetary standards.
5. It motivates the executives to attain targets.

B. Modern Techniques

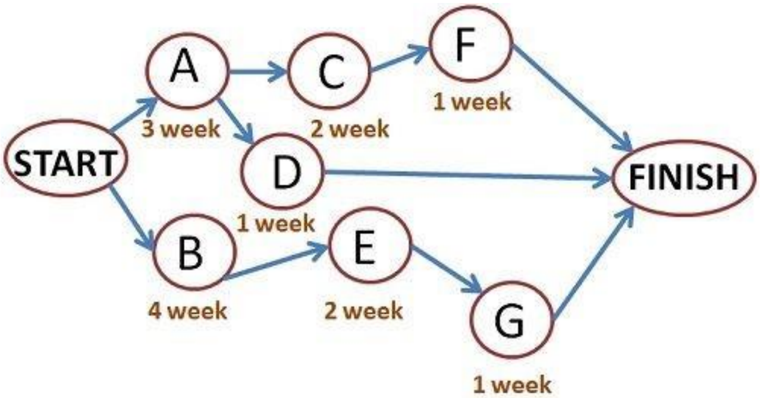
1. **Return on Investment (ROI) –** This technique is used to ensure the capital investment is properly utilised or not in order to get **a reasonable amount of return (profit).**

$$ROI \equiv \frac{NetIncome}{TotalInvestment}$$

2. **Ratio Analysis –** This is a simple technique used for analysing and interpreting data contained in financial statements. This is done through calculating accounting ratios. A ratio is an arithmetic relationship between two figures. Most commonly used accounting ratios are as follows:
   a. **Liquidity ratio –** it is used to ascertain short term solvency of business. It shows the ability of a business to meet its short-term obligations in time. Current ratio, liquid ratio etc. are the examples.
   b. **Solvency ratio –** Solvency here means long term solvency which refers to the ability to meet all liabilities in the event of liquidation. Debt – equity ratio, capital gearing ratio, proprietary ratio etc.
   c. **Profitability ratio –** It is calculated to know the profitability in relation to sales or capital in the business. E.g. Gross profit ratio, Net profit ratio, Return on total sales ratio, Return on capital employed ratio, Return on equity capital ratio etc.
   d. **Turnover ratio –** It reflects the speed at which resources are utilised in effecting sales. A higher turnover ratio means efficient use of resources. E.g. Inventory turnover ratio, Debtors' turnover ratio, Creditors' turnover ratio, working capital turnover ratio etc.
3. **Responsibility accounting –** It is a system of accounting in which different sections or departments in an organisation are taken as "Responsibility Centres". The person in charge of a centre is responsible for achieving the target fixed. Responsibility centres are of the following types:
   a. **Cost centre –** It is a location, a person, a department or an item of equipment for which the cost is ascertained and used for cost control. For example, in a manufacturing unit production department is treated as a cost centre and the production manager is responsible for controlling costs in his department.
   b. **Revenue centre –** A segment of an organization which is primarily responsible for earning revenue is called a revenue centre. E.g. Marketing department is a revenue centre.
   c. **Profit centre –** It is a segment of activity of an organization which is responsible for making profit. In other words, it is a centre responsible for both revenue and costs and thereby profit for a particular activity. Repair and maintenance department may be treated as a profit centre provided it bills other departments for their services.
   d. **Investment centre –** Here the investment is separately calculated and return on investment is taken as the basis for evaluating the performance of that centre.

4. **Management Audit -** It is necessary to evaluate the efficiency of management to ascertain whether the performance of management is according to expected lines. Management audit reveals the achievements of management against the expected performance and also the weaknesses are pointed out.

5. **PERT and CPM –** Program Evaluation and Review Technique (PERT) was developed in the US Navy. The Critical Path Method (CPM) was developed by J.E. Kelly of Remington Rand and M. R. Walker of Dupont. *It is a network analysis technique which is used to determine the time it will take to complete a complex process.* Both are used for planning, scheduling, implementing and controlling time bound projects which involve various complexes, diverse and interrelated activities. These techniques are extensively used in the areas like ship building, construction projects like dams, tunnels, highways, power plants, aircraft manufacture etc.



Steps in PERT and CPM

a. The project is divided into a number of activities.
b. Develop the network diagram incorporating activities involved with a starting point and finishing point.
c. Three time estimates – optimistic, most likely and pessimistic – are made.
d. The longest path in the network is identified as critical path.
e. Plan may be modified for prompt execution and timely completion of the project.

6. **Management Information System (MIS) –** It is a computer based information system which provides information and supports the management for taking effective decisions. MIS also serves the purpose of control technique. Since the data and information are provided at the right time, managers can take appropriate corrective action in case of deviation from the standards fixed.

Advantages of MIS

a. Collection, processing, and dissemination of information at different levels of management is facilitated.
b. Planning, decision making and controlling at all levels in the organisation are supported.
c. Quality of information which is vital for managers is improved.
d. Cost effectiveness is ensured.
e. By providing only the relevant information at the appropriate time, manager is not overloaded with too many information.

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