Management Control Systems 5th edition Merchant Solutions Manual

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Instructor's Manual

Management Control Systems
Performance Measurement, Evaluation, and Incentives

Fifth edition

Kenneth A. Merchant Wim A. Van der Stede

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§ *New case* in this 5th edition of the text.
* *Updated case* from the 4th edition of the text.

Overview of changes in cases from the 4th to the 5th edition:

<u>Cases removed from the 4th edition</u>: 2

1. Houston Fearless 76, Inc.
2. Lernout & Hauspie Speech Products

<u>Note</u>: *These cases are still available for use. Please contact the authors and/or publisher for access to the case text and teaching notes.*

<u>New cases introduced in the 5th edition</u>: 7 [indicated with § in the Table of Contents above]

1. Giroux Glass, Inc. – Bonus Plan
2. To Adjust or Not to Adjust Bonus Payouts?
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<u>Cases updated from 4th edition</u>: **13** [indicated with * in the Table of Contents above]

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12. Golden Parachutes?
13. Dorothy Rishiek: Experiences of a Controller/CFO

Introduction

One constant in the teaching of virtually all courses in management control systems (MCSs) is their heavy use of the case method of instruction. Even instructors who are most comfortable lecturing and/or who like to describe the management control issues through relatively formal (e.g., agency theory) models find it useful to use cases to illustrate the lecture points or the key parameters in the models. This textbook is set up to facilitate the teaching of MCS cases. In addition to the text material, the book includes 70 cases of great variety. Thus, it can be used in courses in which instructors use a case in virtually every class, or it can be used in courses in which only a few cases are used. The model syllabi in the following sections of this manual show this variation: there are syllabi for courses where there is a case in every session, and there are syllabi for courses that use a mixed approach where lectures (without cases) are followed by a session dedicated to the analysis of a case pertaining to the foregoing lecture.

Our own teaching style involves the use of many cases, with considerable student participation in the discussions. This type of course makes some students, particularly those who have not experienced a case course before, possibly uncomfortable, at least initially. We thus sometimes find it necessary to "sell" the advantages of the case method. To this end, instructors can use the note called "**The Case Method of Instruction: Suggestions for Students,**" which can be handed out either in or before the first day of class. This note is included in this manual for your consideration and possible use.

As for course organization, there is no single one-size-fits-all or "template" approach. Management control is a complex, multi-dimensional subject, and courses in MCSs can be organized in many ways. The outline of the textbook provides one way that we have found useful for organizing the materials. The model syllabi included in the following sections of this manual show some variation, which we have ourselves implemented and tweaked over the years depending on level, length, and purpose of the given course, among other considerations (e.g., whether or not there are visitors for some sessions or part of the course).

Even with the same outline, instructors can choose to use quite different sets of cases and different case orderings. This is because, unlike simple problems, most of the cases included in the book describe rich real-world examples, and real-world examples usually do not illustrate just one point.

Consider, for example, the Statoil case, which is included in Chapter 11 (Remedies to the Myopia Problem) because Statoil uses a key-performance-indicator (KPI) structure that is Balanced Scorecard-like to deal with some issues associated with more traditional approaches to performance measurement, as discussed in Chapter 10 (Financial Performance Measures and their Effects). But the Statoil case can also be used effectively with Chapter 8 (Planning and Budgeting) because Statoil separates the functions of target setting, forecasting and resource allocation using the principles of "Beyond Budgeting." Statoil also relies quite substantially on subjective performance evaluations in determining incentives as discussed in Chapter 9 (Incentive Systems). Finally, students have to consider the industry characteristics, the organization structure, the characteristics of the personnel in key positions, and the company's history (e.g., a recent merger), none of which are dealt with in any specific chapter but which are important to understand when evaluating the effectiveness of a MCS. All told, the Statoil case can be used to focus on any of these issues, but also as a powerful integrative case cutting across several topics related to the design and operation of a management control system. If the instructor is looking to illustrate "Beyond Budgeting" in a more focused manner, then using the Mainfreight case is probably a good choice. The Mainfreight case could have been slotted in Chapter 8 (Planning and Budgeting), but we slotted it in Chapter 11 (Remedies to the Myopia Problem) because the company is keen to try and mitigate the alleged dysfunctional consequences of presumably rigid and possibly myopic traditional budget and target setting processes.

To give another example, the Catalytic Solutions, Inc. case, which is included in Chapter 11 (Combinations of Measures and other Remedies to the Myopia Problem) to illustrate the use of nonfinancial performance measures, can also be effectively used with Chapter 2 (Result Controls), Chapter 6 (Designing and Evaluating MCSs), and Chapter 9 (Incentive Compensation Systems). It deals with designing and evaluating a new, first-time incentive system (Chapter 6) to motivate employees toward generating desired organizational outcomes (Chapter 2) that are primarily nonfinancial and long-term in nature (Chapter 11).

For a final example, consider the case Andrew G. Scavell: Chief Risk Officer. We placed it in Chapter 16 because we also have the Dorothy Rishiek, Experiences of a Controller/CFO case there. Both cases give students an insight into these important controller and risk management roles at the C-suite level. However, the Andrew Scavell case can also be taught pertinently with Chapter 15 focused on corporate governance and related board responsibilities and concerns, of which enterprise risk management (ERM) certainly is one. In Chapter 15, the Andrew Scavell case goes nicely together with the Entropic Communications, Inc. case. Indeed, instructors who wish to spend a bit more time on risk management could easily teach both the Entropic and Andrew Scavell cases, in this order in two consecutive sessions, (which would allow assigning Chapters 15 and 16 as the key reading for each of the consecutive sessions accordingly). The Andrew Scavell case also discusses the implementation process of the "new" ERM system, which dovetails with the coverage in Chapter 6—designing and evaluating MCSs. Finally, given the intricate connection of ERM in this case company with the planning and budgeting systems, the case also could be taught in connection with Chapter 8.

Because we can slot each case in only one chapter, and to help instructors with their case choice decisions, we included in this manual a so-called "**Case Matrix**" showing the multiple links between cases and chapters.

The following pages also show several course organizations we use in various teaching programs. The first syllabus (**Model Syllabus 1**) is for an undergraduate half-semester course taught in a two-classes-per-week format over 7 weeks. The second syllabus (**Model Syllabus 2**) shows the contents of a 5-week module focused on management control as part of a 4-module senior undergraduate management accounting course taught in a two-classes-per-week format (through a combination of weekly lectures and seminars). The third syllabus (**Model Syllabus 3**) is for a 14-week semester-long elective course in the MBA program, thus providing 28 sessions (2 class meetings per week) of materials in this topic area. The final syllabus (**Model Syllabus 4**) is essentially Model Syllabus 3 but offered as a single 3-hour class meeting per week. A format with one long class each week makes it difficult, but not impossible, to use two cases each week. Instead of using two cases, instructors may choose to use lectures, in-class exercises, video clips, etc. to break up the format.

You will also see that we used some cases "out of order," that is, in conjunction with a chapter reading different from the chapter in which the case is included in the book. That is why we emphasize that both the inclusion of the cases in the chapters and these guides are merely illustrative. We encourage instructors to adapt the materials to their own organization and teaching emphasis. In so doing, we hope that the alternatives illustrated in the case matrix will prove helpful.

Finally, some teaching materials have been made available electronically on the publisher's website (www.pearsoned.co.uk/merchant). These include, particularly, instructional PowerPoints for each chapter of the book developed by the second author of this book, as well as databases and Excel spreadsheets for the Vitesse Semiconductor Corporation case; the VisuSon, Inc. case; the Bank of the Desert (A) and (B) cases; and the Fine Harvest Restaurant Group (A) and (B) cases. These cases are particularly useful for helping students improve their "data analytics" skills.

The Table of Contents also shows which cases have been removed from the prior edition, which ones are new to this edition, and which have been updated. Instructors wishing to continue to use some of the cases that we may have removed, please contact the authors and/or publisher for access to these cases and teaching notes. Please also contact us with any other suggestions or comments. We can be reached at:

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Model Syllabus 1

Performance Measurement Issues

Text: K. A. Merchant & W. A. Van der Stede, *Management Control Systems: Performance Measurement, Evaluation, and Incentives* (Pearson).

Course Objectives

This course is designed to broaden and deepen your conceptual and technical understanding of accounting as it is used for management purposes. The emphasis in the course is on *financial controls*, which dominate in importance at managerial levels in all but the smallest organizations. Using financial controls requires managers to make decisions about: (1) responsibility structures (e.g., cost centers, profit centers), (2) performance measures (e.g., market, financial, and/or nonfinancial measures and their combinations), (3) performance evaluations, which take into consideration performance targets or other benchmarks, and (4) rewards (including performance-dependent compensation). The course is issue-oriented, with current and emerging issues as a major focus.

The course is built around a textbook—Merchant and Van der Stede's *Management Control Systems*. The text will be supplemented with some additional materials that will be distributed via Blackboard.

The focus of most of the classes will be on a case that brings the topics "to life" and provides issues for us to discuss. The readings are intended to provide background that is useful for informing the case discussions. For each case, I will provide some Discussion Questions. These questions are intended to help frame and focus your reading and consideration of the course materials.

The cases require advance preparation and thought. I encourage you to prepare the cases in a study group. Much of the learning comes from sharing and discussing your ideas with your peers.

Grading

In-class quizzes		50 points
E-mail questions and class participation		50 points
Final exam		100 points
	Total	*200 points*

The **quizzes** will be given in a few classes on an unannounced basis. As protection against the possibility of a bad day or an unlucky absence, in computing my course grades I will disregard the lowest quiz score.

On the bottom of many of the class assignments, you will see that I have included an "**e- mail question**." Prior to noon before our class pertaining to that assignment, please send me an e- mail message answering the question(s) for that day's class. This is not intended to be a time- consuming obligation. Your answers should be brief—**three sentences or less** for each question.

Your answers to the e-mail questions serve multiple purposes. First, they help me to get to know you and to see how you think. Second, these messages open the communication channels between us. Since you have to send me a message, it is easy to append another thought. In the past, some students have used this opportunity to ask a question on another topic or to give me some feedback about the course. I welcome this. I might also respond immediately to your e-mail question answer. Third, your e-mail answers help me orient the class discussion. For example, they help me both to judge the mindset of the class and to find people with unique perspectives. Finally, the questions are functional because they encourage good advance preparation. The regularity with which you input your e-mail question answers on a timely basis and the quality of your answers will form part of your participation grade.

I assign a material proportion of the grade based on **class participation**. I do this for several reasons. First, it improves my grading accuracy. I think I can learn more from hearing you share your ideas in a long series of classes than I can from reading what you write in a short exam session. I keep track of participation in every class.

But perhaps more important than that, grading class participation motivates class participation, and having highly interactive class sessions helps the learning process. Active class participation encourages students to be well prepared and thus to become active, rather than passive, learners. Participation provides students with the opportunity to gain from the experiences and talents of everyone in the class. Moreover, class participation helps students improve their oral communication skills. This is important because research shows that people in the business world tend to spend very little time reading and even less time writing reports. A great deal of managers' and other professionals' interactions with others are through oral communication.

Class participation evaluations will be based primarily on the quality of the participation in classroom discussions. To be clear on what I am looking for regarding class participation, and to further aid in your preparation, I have listed below some characteristics of effective class participation:

(1) Does the student make points that are especially pertinent to the discussion? Do they increase the understanding of the class or are they simply a regurgitation of the problem or case facts?

(2) Is there continuity in one's contribution from what has been said previously during class, or are the comments disjointed, isolated, or tangential? The best class contributions are those that reflect not only excellent preparation, but also good listening, interpretive, and integrative skills.

(3) Do the comments reflect a willingness to put forth new, challenging ideas or are they always agreeable and "safe"?

(4) Is the participant able and willing to interact with others by asking questions, providing supportive comments, or challenging **constructively** what has been said?

Your participation will be evaluated based on a near-continuous scale, the end points of which can be described as follows:

Outstanding Contributor: This person's contributions reflect exceptional preparation, and the ideas offered are always substantive and provide major insights and direction for the class. If this person were not a member of the class, the quality of the discussions would be diminished significantly.

Unsatisfactory Contributor: This person may be absent from class or someone who rarely participates in class discussion. Alternatively, this person's contribution in class reflects inadequate preparation and/or understanding. Ideas offered are not substantive and provide few, if any, insights and never a constructive direction for the class. Integrative comments and effective arguments are absent. Class comments are either obvious, isolated from the main discussion, or confusing to the class.

The **final exam** will be a take-home exam, likely a case or two. You can take this exam as an individual or as a group. The groups can be as large as four people. In the middle of the course, I will ask you to tell me if you will be taking the exam as an individual or in a group, and if in a group, who is included in your group.

Schedule of Classes

Session 1

Topic: Performance Measurement and the Control Function of Management

In this first class, we will go over the syllabus and get to know each other. Then I will provide a general lecture on management controls and the control uses of performance measures that we will focus on in this course. Finally, we will discuss a short case that will set the stage for our further discussions.

Reading: MV, Chapter 1

Session 2

Topic: Result Controls

In this class, we will examine and critique the performance measurement and incentive system used in a business with which all of you have some familiarity—automobile retailing. The company is privately held, and it makes use of some "nonfinancial" performance measures. In the case, we see a simple use of transfer pricing. We will examine incentives at and below management levels of the organization. Moreover, we see some evidence of people "playing games" with the measures. Understanding the causes, consequences and remedies of game playing is a recurring theme in this course.

Reading: MV, Chapters 2 and 9
Prepare for Class: Case—Puente Hills Toyota

Assignment Question:

Evaluate the performance measurement and incentive systems used at Puente Hills Toyota. What changes would you recommend, if any?

E-mail Question:

As a first approximation, which of the following statements do you believe is most correct, and why:

(1) People are people. They respond approximately equally to many things, including pay-for- performance systems.

(2) To work well, management and incentive systems must be tailored to fit the specific employee group (e.g., nationality, role, age, and gender).

Session 3

Topic: Financial Responsibility Structures

The focus of this session is on one of the main management control system choices—design of the organization's authority and financial responsibility structures.

Reading: MV, Chapter 7
Prepare for Class: Case—Kranworth Chair Corporation (KCC)

Assignment Question:

1. Identify the most important key recurring decisions that must be made effectively for KCC to be successful. In KCC's functional organization, who had the authority to make these decisions? Who has the authority to make these decisions in KCC's new divisionalized organization?
2. Did KCC's top management go too far in decentralizing the corporation? Did they not go far enough? Or did they get it just right? Why?
3. Evaluate KCC's new performance measurement and incentive system. Assuming that KCC will retain its new divisionalized organization structure, what changes would you recommend, if any? Why?
4. Assume that the R&D function is to be decentralized (given to the divisions). Would this necessitate changes to KCC's performance measurement and incentive system? If so, which and why? If not, why not?

E-mail Question:

The vast majority of corporations are decentralized to a considerable degree. What kinds of organizations are best run in a largely *centralized* manner, and why?

Session 4

Topic: Planning and Budgeting

Most firms beyond minimal size, but not all, engage in often extensive planning processes, the annual component of which is called budgeting. The Mainfreight case that we will discuss in this session, however, illustrates the functioning of a large, successful international logistics company that does *not* engage in an annual budgeting process. The goal in this case is to think about what budgeting is, and what it is not, and how Mainfreight can succeed without having a budget, which is a control system element that most companies think is essential. One of the key points of discussion of this session, therefore, is to consider whether there are valid, effective alternatives to budget-based performance management systems, and if so, whether these really are what they claim to be or just budgeting processes under a different guise?

Reading: MV, Chapter 8, and Chapter 3
Prepare for Class: Case—Mainfreight

Assignment Question:

1. At the very least, Mainfreight's management systems are nontraditional.
   a. What are the key elements of Mainfreight's result control systems?
   b. Why did Mainfreight managers decide to take a nontraditional approach?
   c. How does Mainfreight perform the functions typically fulfilled by budgets? Or are some of those functions really not that important?
   d. Does the Mainfreight system address the limitations of traditional budgets? Does it introduce new limitations?
2. Is Mainfreight a well-controlled organization?
3. Should companies that now use an annual budgeting process try to emulate some or all of the management systems used by Mainfreight? Why or why not?

E-mail Question:

Mainfreight's top executives, three of whom are qualified accountants, maintain that their company does not prepare budgets. Is that contention accurate? How should one determine whether a company prepares a budget or not?

Session 5

Topic: Performance Measures

Today's discussion focuses on a company that does not place much emphasis on financial measures of performance. Why? What do they do instead?

Reading: MV, Chapters 10 and 11
Prepare for Class: Case—Catalytic Solutions, Inc.

Assignment Question:

Evaluate the CSI performance measurement and compensation systems. What changes would you suggest be made, if any? Explain.

E-mail Question:

Fast forward 10 years. Assume that CSI has been successful. It is now a much larger, public company. It has three operating divisions (investment centers) that focus on different markets. Would you expect the CSI measurement and compensation system to be different at that time? If so, how and why? If not, why not?

Session 6

Topic: Performance evaluations

In this class, we will continue our discussion of performance evaluations. How can/should firms deal with the effects of uncontrollable events that often obscure managers' impacts on performance measures?

Reading: MV, Chapter 12

Prepare for Class: Case 1—Olympic Car Wash

Assignment Question:

How large should the bonus pool be for the Aalst location?

Prepare for Class: Case 2—Beifang Chuang Ye Vehicle Group

Assignment Question:

To what extent, if at all, should Mr. Zhou provide incentive compensation for his employees when his company is losing money? Why? What factors did you take into consideration in making your judgment?

E-mail Question:

Some companies make performance evaluation and bonus adjustments to protect managers from the harmful effects of many uncontrollable factors. Other companies make no such adjustments. Is one of these approaches clearly inferior, or is this just a "management style" choice?

Session 7

Topic: Enterprise Risk Management

Our focus in this session is on enterprise risk management, a newly developing tool aimed at helping companies address all the various kinds of risks they might face.

Prepare for Class: Case—Entropic Communications, Inc.

Assignment Question:

1. Why did Entropic implement a formal enterprise risk management (ERM) process?
2. Do you think the company realized the benefits of ERM as envisioned by COSO? Why or why not?
3. What changes would you suggest for making the ERM process at Entropic more effective?

E-mail Question:

ERM is currently one of the hottest topics being written about in management, accounting, and corporate governance practitioner journals. Virtually every company is looking at the technique and deciding whether and how to use it. Do you think the ERM technique is a fad that will soon disappear or an improvement that will provide enduring benefits to a broad range of companies?

Session 8

Topic: Objectives Beyond Profit Maximization

In this session we will focus on the management control implications stemming from the broader goal of "stakeholder welfare" maximization, rather than merely "shareholder wealth". This is entirely within the relatively recent, but increasingly emphasized, context of corporate social responsibility (CSR) and the consideration by organizations of environmental, social and governance (ESG) factors in their strategies and MCSs to ensure that any non-shareholder stakeholder interests are effectively pursued.

Reading: MV, Chapter 13
Prepare for Class: Case—Microsoft Corp.: CSR Execution

Assignment Question:

1. Why do Microsoft managers, led by Satya Nadella, believe that they have responsibilities beyond merely maximizing shareholder value?
2. Sometimes fulfilling corporate social responsibilities are coincident with shareholder value maximization. Eliminating waste on a production line provides a good example of that. But other times there are trade-offs between the financial and other dimensions of performance. Identify three Microsoft programs of each type; that is, three that obviously create value for Microsoft shareholders and three that have been implemented out of a sense of social responsibility even though they are costly to the company, at least in the short term.
3. An old adage of management, often attributed to Peter Drucker, states that, "What gets measured gets managed." In some level of detail, the case describes how nine major CSR programs are being executed at Microsoft:

    a. carbon sustainability
    b. energy sustainability
    c. water sustainability

d. waste sustainability
e. ecosystems sustainability
f. product accessibility
g. responsible sourcing (which includes human rights, employee safety, sustainability) of direct supplies
h. responsible sourcing of indirect supplies
i. human rights (including freedom of expression and privacy, data security, and online safety)

The ability to measure performance varies significantly across these areas. In what areas is success easiest to measure? Most difficult to measure? How does Microsoft's execution strategy vary significantly depending the ability to measure success?

4. In your opinion, are some programs executed more effectively than others? If so, what makes those execution strategies particularly effective? Is there one execution approach that promises the best chances for success for most programs, or are there different ways of achieving program success?

E-mail Question:

At some point, Satya Nadella will be replaced by a new CEO at Microsoft. How much, and maybe which specifically, of the CSR initiatives are likely to survive the change in leadership? Why?

Session 9

Topic: Earnings Management and the Roles of Controllers and CFOs

In this session, we will examine some of the important roles that controllers and CFOs play in their organizations, particularly in times of stress.

Reading: MV, Chapter 16
Prepare for Class: Case—Dorothy Rishiek: Experiences of a Controller/CFO

Assignment Question:

1. Was Dot Rishiek a good controller for Especial Foods? Why or why not?
2. Does Dot have the power to force SCI top management to make a correcting accounting entry? If not, what should she do? If so, should she force the entry to be made, and how large should it be?
3. Are earnings management practices such as took place at Especial and SCI smart? Are they ethical?
4. Does Dot Rishiek have an obligation greater than that of other employees to try to ensure that her corporation acts ethically?

E-mail Question:

All things considered, was Dot Rishiek a good controller for Especial Foods? Did she deserve hearty congratulations and a nice bonus or a boot out the door? Explain briefly.

Session 10

Topic: Corporate Governance and the Roles of Boards of Directors

In this class, we will focus broadly on systems of corporate governance and the roles and obligations of boards of directors.

Reading: MV, Chapter 15 (already assigned for Session 8)
Prepare for Class: Case—Arrow Motorcar Corporation

Assignment Question:

1. Why did Arrow Motorcar Corporation have a board of directors before it went public? How (if at all) do the legal and moral obligations of private-company directors differ from those of directors of publicly-held companies?
2. Evaluate the board composition and actions. All things considered, did the board act properly? Did the board members choose the optimal time to terminate Billy Ray Repko?
3. What should the board members do now (March 22, 2016)?
4. What could have prevented or minimized the problems that Arrow faced?

E-mail Question:

If the Sarbanes-Oxley law had been passed before the time of this case, do you think the problems faced by the board of Arrow Motorcar Corporation would have occurred? Explain.

Session 11

Topic: Industry application: A Sales Incentive System

Managers at Office Solutions, Inc., are considering a significant change in the compensation plan for some of the company's sales representatives. Are they on the right track? Can we give them suggestions for improvement of their ideas? I expect that the key managers at Office Solutions will be in our class to listen to our suggestions and to engage in an active discussion with the class.

Prepare for Class: Case—Office Solutions, Inc.

Assignment Question:

1. Evaluate the new approach for compensating the sales representatives at Office Solutions. In your critique, consider, at a minimum:
   - The recognition of the two different types of representatives;
   - The performance measures;
   - The performance standards;
   - The forms, mixes and amounts of compensation.
2. Why are at least some of the representatives resistant to the change? How should that resistance be addressed?
3. Would Office Solutions be better off if all its sales representatives were good at "hunting"? If so, how should the company move in that direction?

E-mail Question:

Bob Mairena has realized that most of his older sales representatives, those over the age of 50, are not good at generating new accounts. Is this problem fixable, maybe through the compensation system, or should the company somehow find a way to employ only young reps? If the latter, how might that be accomplished?

Session 12

Topic: Industry Application: A "billings scorecard"

In this class, we will discuss an innovative result-control approach to solution of a problem that is usually addressed with development and enforcement of sets of policies and procedures.

Reading: MV, Chapter 6
Prepare for Class: Case—Game Shop, Inc.

Assignment Question:

1. Why was GSI's production quality control performance so much better than its billing performance?
2. Evaluate the billing improvement effort and each of the elements of the system that emerged. Comment specifically on the billing scorecard, detention meetings, P-CARs, and any other system elements that you believe are relevant.
   a. In considering the scorecard, be sure to address the following questions: What are the Scorecard and each of its measures trying to accomplish? Are these the right measures? Does each measure add unique value? Are the measures weighted appropriately in importance? Are the business unit grades generally consistent across measures? Can any of the measures be distorted or gamed?
   b. Do you believe that David's improvement efforts will close the gap between production and billing performance enough to meet project goals? Explain?
   c. Do you have any suggestions to improve the billing process? Explain.
3. GSI's ultimate goal is "perfection." Can this system be used to achieve billing perfection as it is designed, or will changes have to be made, or might even a totally different approach be necessary? Explain.
4. The Billing Scorecard is a result-accountability approach to address the problem, chosen because this company's culture is "metrics centric." What are the advantages and disadvantages of using a result-accountability approach? What other alternatives might have been used to solve the problem?

E-mail Question:

Would you include billing performance among a short list of "critical success factors" for GSI? If so, why has it apparently not received much attention from management up until now? If not, why all the concern now?

Session 13

Topic: Industry application: A bank

In this session, we will focus on the performance measurement/management control challenges in the wholesale banking industry.

Reading: MV, Chapters 4, 5
Prepare for Class: Case—Haengbok Bancorp

Assignment Question:

1. Evaluate Haengbok Bancorp's system of controlling the behaviors of the account managers in the Los Angeles branch. What changes would you suggest be made, if any? Explain. In your answer, comment specifically on the merits and demerits of the control philosophy and each of the significant individual control

system elements, such as the use of mini profit centers and the associated performance measures and incentives.

2. Discuss the FETC loan application situation and the effects that outcome might have on the account managers' behaviors and performances? Does this example illustrate a problem that needs to be fixed? If not, why not? If so, how would you fix it? Explain.

E-mail Question:

Are any of the issues in this case or their preferred solutions affected in any way by the fact that the bank and its managers are Korean, rather than, say, American, French, or Chinese?

Session 14

Topic: Industry Application: A Hedge Fund

In this class, we will discuss issues related to performance evaluation and incentive compensation in a hedge fund. Our primary focus will be on the role of the hedge fund analysts.

Prepare for Class: Case—Raven Capital, LLC

Assignment Question:

1. Assume the role of a Raven portfolio manager who has to allocate a bonus pool to the four analysts working primarily for him. Assume a 20% incentive fee for Raven. Use 30% of the incentive fee as the bonus pool to be allocated to the four analysts whose backgrounds and 2009 portfolio performances are described in Assignment Figures A and B (posted separately on Blackboard).
   a. How would you allocate bonuses to these four analysts? What alternatives did you consider? Why did you make the choices you did?
   b. Is there any other information you would like to have had available before making your decisions? If so, which?
   c. Do you think you should pay out the entire bonus pool this year, or hold some money in a "bonus bank reserve"? Why or why not?
   d. Should the proportions of the bonuses allocated vary depending on the size of the bonus pool available? Redo the allocations of the bonus pool to these four analysts assuming that because of a high-water mark constraint, the incentive fees earned in 2009 were only $300,000.
2. Evaluate the Raven performance evaluation and incentive compensation system. What changes would you recommend, if any?

E-mail Question:

What could Raven management do to make it possible to evaluate the analysts' performances more objectively? Should they make these changes?

After we discuss this case, I will provide a brief review of the major themes of the course and will hand out the final exam. It will be a take-home exam. You can work on the exam only in the group to which we agree you have been assigned.

Model Syllabus 2

Advanced Managerial Accounting

Introduction

Module 1 of [this management accounting course] is focused on the study of the quintessential role of management control in decentralized organizations. Our focus will be on the measurement and evaluation of the performances of organizational entities and their managers. Management accounting at this level of analysis is an integral part of companies' *management control systems*.

In this module, we will discuss what it means to have an organization be "in control," what alternatives managers have for ensuring good control, and how managers should choose from among control system alternatives. Then we will focus on each of the elements of "financial control systems," which provide the dominant form of control in most decentralized organizations. These elements include financial target setting (as part of organizations' planning and budgeting processes), performance measurement and evaluation, and the assignment of various forms of organizational rewards, such as bonuses and promotions.

This module is intended as an introduction for individuals who will make business decisions, evaluate organizational performance, or evaluate others (and/or be evaluated) using financial and nonfinancial information. In other words, the module is designed to be useful particularly for those who aspire to be managers, management consultants, or specialists in staff functions such as controllers, financial analysts, auditors, and human resource specialists.

Teaching Format

This module is taught as five lectures and five classes, and the materials in this module will be presented through both lectures and case study analyses. The case studies permit the exploration of management control issues in a broad range of settings (e.g., large and small firms, manufacturing and service firms, multinational firms, start-ups).

The case method of instruction requires good advance preparation by the students. For the cases that we discuss in *class* settings, I expect *every* student to actively participate in the case analysis and discussion. Although during *lectures* not every student will have an opportunity to contribute to the discussion, I still expect active participation when I pose questions or solicit input from the students.

Course Materials

Merchant, Kenneth A., and Wim A. Van der Stede, *Management Control Systems: Performance Measurement, Evaluation, and Incentives* (Pearson) [**MCS** in the schedule below].

Some additional materials are distributed separately in the **course pack**.

Written Work

You are expected to hand in one essay for this module drawn from the list of "essay questions" listed throughout the schedule below. Because each essay question is related to a case study, you must turn in your essay of choice *at the beginning* of the session in which the case is discussed. An essay that is handed in after the case has been discussed in class will not be marked.

Assessment

Assessment will be based wholly upon a 3-hour written examination during the Summer Term covering exam questions from across all four modules of this course. Past examination papers are available on the Library's website.

Module Schedule

Week 1—The Control Function of Management

Lecture 1: MCS Chapters 1-6
Class 1: *Puente Hills Toyota*

Case Questions (for advance preparation):

1. Evaluate the performance measurement and incentive systems in use at Puente Hills Toyota in terms of their overall effectiveness as a "result control" system.

2. Elaborate specifically on the specific features of the result control system in place at Puente Hills Toyota—strengths and weaknesses?

3. What factors are critical for Puente Hills Toyota's success? What changes would you recommend, if any?

Essay Question (for written work): Considering that Puente Hills Toyota's is probably quite a "typical" incentive system one might find in customer-driven, sales-focused organizations (in the US), please comment on the following statement:

> People are people and they respond equally to many things, including pay-for- performance systems, and thus incentive systems will work well anywhere and in any organization.

Week 2—Result Accountability

Lecture 2: MCS Chapter 7
Class 2: *Kranworth Chair Corporation*

Case Questions (for advance preparation):

1. Identify the most important key recurring decisions that must be made effectively for Kranworth Chair Corporation (KCC) to be successful. In KCC's functional organization, who had the authority to make these decisions? Who has the authority to make these decisions in KCC's new divisionalized organization?

2. Did KCC top management go too far in decentralizing the corporation? Did they not go far enough? Or did they get it just right? Why?

3. Evaluate KCC's new performance measurement and incentive system. Assuming that KCC will retain its new divisionalized organization structure, what changes would you recommend, if any? Why?

Week 3—Planning and Budgeting

Lecture 3: MCS Chapter 8
Class 3: *Mainfreight*

Case Question (for advance preparation),

1. At the very least, Mainfreight's management systems are nontraditional.
   a. What are the key elements of Mainfreight's result control systems?
   b. Why did Mainfreight managers decide to take a nontraditional approach?
   c. How does Mainfreight perform the functions typically fulfilled by budgets? Or are some of those functions really not that important?
   d. Does the Mainfreight system address the limitations of traditional budgets? Does it introduce new limitations?
2. Is Mainfreight a well-controlled organization?
3. Should companies that now use an annual budgeting process try to emulate some or all of the management systems used by Mainfreight? Why or why not?

Essay Question (for written work): Mainfreight's top executives, three of whom are qualified accountants, maintain that their company does not prepare budgets. Is that contention accurate? How should one determine whether a company prepares a budget or not?

Week 4—Performance Measurement

Lecture 4: MCS Chapters 10-12; and,

Kaplan Robert S. & David Norton (2005), The Balanced Scorecard: Measures that Drive Performance, *Harvard Business Review*, July-August, pp. 172-180.

Ittner, Christopher D., & David F. Larcker (2003), Coming up Short on Nonfinancial Performance Measurement, *Harvard Business Review*, November, pp. 88-95.

Class 4: *Catalytic Solutions, Inc.*

Case Questions (for advance preparation):

1. Evaluate the composition of the compensation package at CSI.
   a. What are the advantages and disadvantages of awarding stock options?
   b. What are the advantages and disadvantages of awarding bonuses?
   c. Was the relative importance placed on salaries, stock options, and bonus awards reasonable? Why should CSI offer a mix of rewards rather than providing its employees 100% of their compensation based on 100% salary? On 100% annual bonuses?

2. Evaluate the specific features of the annual bonus plan in 2001 and 2002. Comment on:
   a. the choice of the number of measures used, the specific measures used, and the changes in the plan between years;
   b. the relative proportions of financial vs. nonfinancial measures;
   c. the decision to base rewards on company-wide, rather than individual, performance;
   d. the amount of subjectivity allowed in determining the bonus awards;
   e. the calibration (target difficulty) of the bonus plans.

Essay Question (for written work): Fast-forward 10 years. Assume that CSI has been successful. It is now a much larger, public company. It has three operating divisions (investment centers) that focus on different markets. What would you expect the CSI measurement and compensation systems to look like at that time? Why?

Week 5—Incentive Systems

Lecture 5: MCS Chapter 9; and,

Van der Stede, Wim A. (2007), The Pitfalls of Pay-for-Performance, *Finance & Management*, 150, December, 10-13.

Van der Stede, Wim A. (2009), Designing Effective Reward Systems, *Finance & Management*, 168, October, 6-9.

Class 5: *Giroux Glass, Inc.*

Case Questions (for advance preparation):

1. What were the objectives of the bonus plan? What were the outcomes?

2. Did the outcomes meet the objectives, why or why not? Could improvements be made with the bonus plan structure (measures, timing, and compensation), or with communication, or both?

3. Is the bonus plan necessary to achieve objectives? Would they be achieved regardless with other existing programs? (ESOP, generous compensation package, PBT incentive, company culture, etc.)

4. Several employees thought the explanation of the bonus plan that they received was confusing. Examine Exhibit 5 – Giroux Glass Incentive Plan Sample. Redesign the exhibit or develop an alternative to explain the bonus plan to employees more clearly.

Model Syllabus 3

Management Control Systems

Text K. A. Merchant & W. A. Van der Stede, *Management Control Systems: Performance Measurement, Evaluation, and Incentives* (Pearson).

Course Objectives

Firms' performance evaluation and incentive systems require managers to make many choices. They must design responsibility structures. If performance is defined in accounting terms, as is common at managerial levels of the firm, these structures are composed of configurations of cost centers, revenue centers, profit centers, and investment centers. They have to choose specific performance measures and make them operational. Just within the category of accounting-based measures, which are in common use, are measures with acronyms such as EBITDA, ROE, RONA, ROCE, ROI, RAROC, and RI. And, of course, many market- based and nonfinancial measures are also used frequently. Managers must select measurement windows (e.g., month, quarter, annual, multi-year) for any of the measures chosen. And they have to define the links between the measured performance and various forms of organizational rewards and punishments. Unless all these choices are made well, problems can result. These systems can frustrate and demotivate employees or, worse, encourage them to do the wrong things.

This course presents knowledge of these "result-accountability" systems, with current practice and emerging issues as a major focus. Among the issues, we will discuss the advantages and disadvantages of traditional financial measures and nontraditional measures such as EVA, EBITDA, and "pro-forma" earnings, as well as nonfinancial measures (e.g., customer satisfaction) and combinations found in dashboards and balanced scorecards. We will also discuss incentives-related topics, such as "stress-testing" and resource allocation uses of financial plans, the "beyond budgeting" movement, performance assessment by internal and operational auditors, and management implications of the Sarbanes-Oxley Act and the still- developing enterprise risk management (ERM) techniques.

The focus of most of the classes will be on discussions of specific cases developed from real-world practice. The assigned readings are intended to provide background that is useful for informing the case discussions. For each case assignment, I provide some Discussion Questions. These questions are intended to help frame and focus your reading and consideration of the course materials. In a number of the classes, I will invite a practitioner visitor to class both to add expertise and to "bring the topics to life."

The course is built around a textbook—Merchant and Van der Stede's *Management Control Systems*. The text is supplemented with a short monograph (de Kluyver's *A Primer on Corporate Governance*):

(MV) K. A. Merchant & W. A. Van der Stede, *Management Control Systems* (Pearson).
(deK) C. de Kluyver (2009), *A Primer on Corporate Governance* (Business Expert Press).

Some additional materials also will be distributed on Blackboard.

Grading

Quizzes		40 points
Project 1		40 points
Project 2		40 points
Project 3		40 points
Class participation		40 points
Final exam		100 points
	Total	*300 points*

Quizzes and Exams

The quizzes and the final exam will test **individual** (not group) work. The **quizzes** will focus on specific issues in the case being discussed that day in class. The **final exam** will be a take-home exam in lieu of an exam during the final exam period. It will involve a case analysis.

Projects

The projects will involve group analyses of cases that are supported by data provided on Excel spreadsheets. The first project is a capital budgeting exercise. The second is a budget "stress testing" exercise. The third involves comparative performance evaluations of a large number of bank branches. Some groups will be asked to present their analyses and conclusions in class.

Students can form their own working groups, but I will help if needed. The optimum (and maximum) group size is four. I will accept groups as small as three. As part of the grading process, I will ask students to grade each of their fellow group members. This is done to try to reduce the "free-rider" effect.

Class Participation

I assign a material proportion of the grade based on **class participation** for several reasons. First, it improves my grading accuracy. I think I can learn more from hearing you share your ideas in a long series of classes than I can from reading what you write in a few short exam sessions.

But perhaps more important than that, grading class participation motivates class participation, and having highly interactive class sessions helps the learning process. Active class participation encourages students to be well prepared and thus to become active, rather than passive, learners. Participation provides students with the opportunity to gain from the experiences and talents of everyone in the class. And class participation helps students improve their oral communication skills. This is important because research shows that people in business tend to spend very little time reading and even less time writing reports. A great deal of managers' and other professionals' interactions with others are through oral communication.

Class participation evaluation will be based primarily on the quality of the participation in classroom discussions. To be clear on what I am looking for regarding class participation, and to further aid in your preparation, I have listed below some characteristics of effective class participation:

(1) Does the class member make points that are especially pertinent to the discussion? Do they increase the understanding of the class or are they simply a regurgitation of the problem or case facts?

(2) Is there continuity in one's contribution from what has been said previously during class, or are the comments disjointed, isolated, or tangential? The best class contributions are those that reflect not only excellent preparation, but also good listening, interpretive and integrative skills.

(3) Do the comments reflect a willingness to put forth new, challenging ideas or are they always agreeable and "safe"?

(4) Is the participant able and willing to interact with others by asking questions, providing supportive comments or challenging **constructively** what has been said?

Participation will be evaluated based on a near-continuous scale, the end points of which can be described as follows:

Outstanding Contributor: This person's contributions reflect exceptional preparation, and the ideas offered are always substantive and provide major insights and direction for the class. If this person were not a member of the class, the quality of the discussions would be diminished significantly.

Unsatisfactory Contributor: This person may be absent from class or someone who rarely participates in class discussion. Alternatively, this person's contribution in class reflects inadequate preparation and/or understanding. Ideas offered are not substantive and provide few, if any, insights and never a constructive direction for the class. Integrative comments and effective arguments are absent. Class comments are either obvious, isolated from the main discussion, or confusing to the class.

E-Mail Questions

On the bottom of many of the class assignments, you will see that I have included an "e- mail question." Prior to noon before each of our classes, please send me an e-mail message or private Blackboard posting answering the question(s) for that day's class. This is not intended to be a time-consuming obligation. Your answers should be brief—**three sentences or less** for each question.

Your answers to the e-mail questions serve multiple purposes. First, they help me to get to know you and how you think. Second, these messages open the communication channels between us. Since you have to send me a message, it is easy to append another thought. In the past some students have used this opportunity to ask a question on another topic or to give me some feedback about the course. I welcome this. Third, your e-mail answers help me orient the class discussion. For example, they help me both to judge the mindset of the class and to find people with unique perspectives. Finally, the questions are functional because they encourage good advance preparation. The regularity with which you input your e-mail question answers on a timely basis and the quality of your answers will form part of your participation grade.

Schedule of Classes

Session 1

Topic: The Control Function of Management

In this first session, we will go over the syllabus and get to know each other. Then I will provide a general lecture on managers' control options. Finally, we will discuss a control vignette.

Reading: MV, Chapters 1–4

Session 2

Topic: Control System Alternatives and What Can Go Wrong

No MCS is perfect. Some controls fail, and others cost more than the benefits they provide. Today we will examine a company that suffered significant problems. Could they have been prevented? If so, how?

Reading: MV, Chapter 5
Prepare for Class: Case—Atlanta Home Loan

Assignment Questions:

1. Identify the devices (controls) that Al Fiorini used to control his business both before and after he went back to school. Classify each control as a result, action, or personnel or cultural type of control.
2. What went wrong? Did Al use the wrong types of controls? Did he use the right types of controls but fail to design or implement them properly? Or was he just unlucky?

E-mail Question:

What should Al Fiorini do now? Why?

Session 3

Topic: Evaluating Control System Alternatives

Today's case illustrates the control system used in a field service engineer (FSE) setting. The case is particularly interesting because the company, Diagnostic Products Corporation (DPC), is in the midst of a significant change. Formerly, company managers controlled FSE inputs—they paid FSEs for hours worked. Now they are attempting to measure FSE outputs, or results, and to provide performance-dependent compensation.

Reading: MV, Chapter 6
Prepare for Class: Case—Diagnostic Products Corporation (DPC)

Assignment Questions:

Evaluate the design of the DPC Performance Bonus Program for U.S.-based field service engineers (FSEs) as it currently exists and the way in which the Program is being implemented. What changes would you suggest, if any?

E-mail Question:

Instead of using a result-control system like the Performance Bonus Program could DPC control its U.S.-based FSEs effectively using only action and/or personnel/cultural controls?

Session 4

Topic: Financial Responsibility Structures

The focus of this session is on one of the main management control system choices—design of the organization's authority and financial responsibility structures.

Reading: MV, Chapter 7
Prepare for Class: Case—Kranworth Chair Corporation

Assignment Questions:

1. Identify the most important key recurring decisions that must be made effectively for KCC to be successful. In KCC's functional organization, who had the authority to make these decisions? Who has the authority to make these decisions in KCC's new divisionalized organization?
2. Did KCC top management go too far in decentralizing the corporation? Did they not go far enough? Or did they get it just right? Why?
3. Evaluate KCC's new performance measurement and incentive system. Assuming that KCC will retain its new divisionalized organization structure, what changes would you recommend, if any? Why?
4. Assume that the R&D function is to be decentralized (given to the divisions). Would this necessitate changes to KCC's performance measurement and incentive system? If so, which and why? If not, why not?

E-mail Question:

Many corporations are decentralized to a considerable degree. What kinds of organizations are best run in a largely *centralized* manner, and why?

Session 5

Topic: Interdependence and the Transfer Pricing Problem

Where products or services are provided by one organizational entity to another, difficult cost allocation or transfer pricing problems often follow. In this session, we will discuss a representative example.

Prepare for Class: Case—Zumwald AG

Assignment Questions:

1. What sourcing decision for the X73 materials is in the best interest of:
    a. The Imaging Systems Division?
    b. The Heidelberg Division?
    c. The Electronic Components Division?
    d. Zumwald AG?
2. What should Mr. Fettinger do?

E-mail Question:

Is a transfer price just a cost allocation with a profit margin tacked onto it? Explain.

Session 6

Topic: Planning and Budgeting

Most firms beyond minimal size, but not all, engage in often extensive planning processes, the annual component of which is called budgeting. The Mainfreight case that we will discuss in this session, however, illustrates the functioning of a large, successful international logistics company that does *not* engage in an annual budgeting process. The goal in this case is to think about what budgeting is, and what it is not, and how Mainfreight can succeed without having a budget, which is a control system element that most companies think is essential. One of the key points of discussion of this session, therefore, is to consider whether there are valid, effective alternatives to budget-based performance management systems, and if so, whether these really are what they claim to be or just budgeting processes under a different guise?

Reading: MV, Chapter 8
Prepare for Class: Case—Mainfreight

Assignment Questions:

1. At the very least, Mainfreight's management systems are nontraditional.
   a. What are the key elements of Mainfreight's result control systems?
   b. Why did Mainfreight managers decide to take a nontraditional approach?
   c. How does Mainfreight perform the functions typically fulfilled by budgets? Or are some of those functions really not that important?
   d. Does the Mainfreight system address the limitations of traditional budgets? Does it introduce new limitations?
2. Is Mainfreight a well-controlled organization?
3. Should companies that now use an annual budgeting process try to emulate some or all of the management systems used by Mainfreight? Why or why not?

E-mail Question:

Mainfreight's top executives, three of whom are qualified accountants, maintain that their company does not prepare budgets. Is that contention accurate? How should one determine whether a company prepares a budget or not?

Note: The names of the individuals working on the two group projects are due to me by the start of this class. The optimum (and maximum) group size is four. Groups of three are permissible. Please have a representative send me an e-mail message with the names of the individuals in your group.

Session 7

Topic: Business Models and Resource Allocations (Group Project #1)

Many resource allocation decisions are made during companies' planning and budgeting processes. Obviously companies want to make good investments, but is maximizing NPV (or IRR) always the most important decision-making criterion?

Prepare for Class: Case—Vitesse Semiconductor Corporation

Assignment Questions:

The detailed assignment for the Vitesse Semiconductor Corporation case is distributed in the assignments section of Blackboard. For this project you will hand in a report. There will be no in- class group presentations beyond needing to be ready to speak when being called as we discuss the case as usual.

Session 8

Topic: Result Controls (or Not)

In this session, we will examine and critique the performance measurement and incentive systems in two companies in an industry with which all of you have some familiarity— automobile retailing. The two companies' systems are quite different. Can we say which one is the better design?

Reading: MV, Chapter 9
Prepare for Class: Cases — Puente Hills Toyota

Kooistra Autogroep

Assignment Questions:

1. Compare and contrast the performance measurement and incentive systems used at Puente Hills Toyota and Kooistra Autogroep.
2. When comparing the use of incentives in the two companies, do you believe that incentive pay is truly effort-inducing; that is, does it drive employees to perform at their best? If you believe incentive pay is not, in whole or in part, effective in making employees work harder, then what other potentially useful purposes does variable incentive pay provide for organizations relying on it, if any?
3. What advice would you provide to the managers of these companies?

E-mail Question:

As a first approximation, which of the following statements do you believe is most correct, and why:

(1) People are people. They respond approximately equally to many things, including incentive systems.
(2) To work well, a company's incentive systems must be tailored in many ways to fit the specific desires of various employee groups.

Session 9

Topic: Summary Financial Performance Measures: Advantages and Limitations

There are many forms of summary financial performance measures. Are some better than others?

Reading: MV, Chapter 10
Prepare for Class: Case — Behavioral Implications of Airline Depreciation Accounting Policy Choices

Assignment Questions:

Assume that at least some rewards for the management team (and, hence, also other employees) are based on performance measured in terms of accounting income and returns on net assets. Also assume that all of these airlines are growing; that is, they are adding to their fleet of aircraft.

1. What are the behavioral implications of each of the three depreciation-related accounting policy choices:
   a. depreciation patterns (i.e., straight-line vs. accelerated);
   b. estimated useful lives; and
   c. residual values?

Consider, at a minimum, the effects of each of these choices on decisions regarding:

a. replacements of aircraft in service;
b. pricing, assuming that prices are at least somewhat dependent on costs;
c. evaluations of routes or lines of business;
d. evaluations of managers, assuming that negotiated budgets provide the primary standards of performance.

2. Assume that in a particular U.S. airline company there is a conflict between the benefits of conservatism vs. liberalism in depreciation accounting. That is, for this company conservatism in depreciation accounting is greatly preferred for financial reporting purposes (for whatever reason) but for internal purposes the company would be better off if the policies were more liberal, or vice versa. Would you recommend to the managers of this company that they adopt a third set of books? That is, should they maintain one set of books for financial accounting purposes, another set for tax purposes, and a third set for the purposes of running the business?

3. If the managers of a particular airline do not want to maintain a third set of books, should they tend to be conservative or liberal in their aircraft depreciation accounting?

E-mail Question:

International Financial Reporting Standards (IFRS) are less prescriptive than current U.S. GAAP, and the interpretive guidance that is provided is more limited. More judgment is needed by managers in firms following IFRS, so this question will become more relevant after U.S. firms shift over to IFRS: Should judgments about financial reporting policies be affected significantly by concerns about the possible effects on behaviors of employees of the firm, or should they be chosen solely based on judgments about what is perceived to provide the best financial reporting disclosures?

Session 10

Topic: New "Improved" Summary Financial Measures of Performance

We will start discussing the performance measurement element of financial control systems. In this session, we will discuss some relatively new financial performance measures that are said to be improved because they provide better indications of value creation. These are essentially modifications of accounting "residual income" that have been given labels with some marketing appeal, such as "economic profit" or "economic value added."

Prepare for Class: Case—Berkshire Industries, Inc.

Assignment Questions:

1. Were Berkshire's motivations for a new incentive system reasonable? If so, what were their main options for a new system? Was an economic profit-focused system a reasonable choice?

2. Evaluate the Berkshire Industries' new incentive plan. What changes would you recommend, if any?

3. What, if anything, should Mr. Embleton do about the problems caused by performance shortfalls in the Spirits Division? Explain.

E-mail Question:

Would an economic profit-based incentive compensation system similar to that used by Berkshire be effective in an Internet start-up company? Why or why not?

Session 11

Topic: Market Measures of Performance

Today our focus is on market measures of performance and, in particular, the incentive effects of stock option grants.

Reading: MV, Chapter 11
Prepare for Class: Case—Superconductor Technologies, Inc.

Assignment Questions:

1. Evaluate the performance measurement and incentive system that STI uses for its top-30 managers. Among the questions you should consider:
   a. Will the system attract managers' attention and influence behavior in the desired ways?
   b. Is the system achieving other (nonmotivational) purposes that it is also intended to serve?
   c. Is each of the elements worth the cost?
   d. Is the mix of rewards optimal?
   e. What changes would you recommend, if any?
2. Should the accounting treatment matter? That is should the accounting rule change requiring the immediate expensing of the value of stock options granted (which has now happened) have caused STI to make any changes to its system? If so, which?
3. Will STI have to make changes to its system if and when it expands internationally and employs managers in locations such as London and Shanghai? If so, which?

E-mail Question:

Assume that you, as an STI employee, were awarded options on 100,000 shares of STI stock (symbol: SCON) at market close yesterday at the current market price. Without doing a detailed numerical calculation, what would you estimate the value of that option grant to be for you? (That is, what is the minimum price at which you would be willing to sell the options immediately?) What factors did you consider in making your estimate?

Session 12

Topic: Combinations of Measures: KPIs, Dashboards, and Balanced Scorecards

The focus of this session is on the concurrent use of multiple performance measures. The most popular combination-of-measures system is marketed under the rubric "Balanced Scorecard." But some variations are given alternative names, such as dashboards, KPIs, and performance prisms.

Prepare for Class: Case: Johansen's—The New Scorecard System

Assignment Questions:

1. Why has Johansen's introduced the new scorecard system?
2. What is the company's strategy? What are the key success factors for successfully implementing that strategy? Describe the organizational structure in place at the company.

3. Consider each of the four perspectives of Johansen's new scorecard system. Why are they included? How are they measured?

4. What rating do you advocate awarding Clark? What are the key arguments you use to support that rating?

E-mail Question:

What kinds of companies should implement a basket-of-measures approach, such as balanced scorecard, rather than just monitoring and rewarding their general managers' performances based on a single bottom-line summary performance measure?

Session 13

Topic: The Planning Role of Budgets: Business Stress Testing
(Group Project #2)

As you should know by now, planning is decision-making in advance. Using the financial statement format in a future-looking sense (i.e., budgeting) allows managers to anticipate what might be coming their way in various plausible scenarios.

Case: VisuSon, Inc.

There is no assignment due for this class and, in fact, ***we will not meet for this class period***. You can use the time to work on Group Project #2. The assignment is posted on Blackboard. We will hear some of the presentations and will discuss the case in the next class.

Session 14

Topic: The Planning Role of Budgets: Business Stress Testing (cont.)

In this class session, we will consider the work you have done for your first group project. Some of the groups will present their findings. The group presentations will either reinforce each other or, if they are different, we will compare and contrast them.

Case—VisuSon, Inc.

Session 15

Topic: Performance Evaluations: Adjusting for the Effects of "Uncontrollables"

In this class, we will continue our discussion of performance evaluations. How can/should firms deal with the effects of uncontrollable events that often obscure managers' impacts on performance measures?

Reading: MV, Chapter 12
Prepare for Class: Cases — Olympic Car Wash
Beifang Chuang Ye Vehicle Group

Assignment Questions:

For ***Olympic Car Wash***:

How large should the bonus pool be for the Aalst location?

For ***Beifang Chuang Ye Vehicle Group***:

To what extent, if at all, should Mr. Zhou provide incentive compensation for his employees when his company is losing money? Why? What factors did you take into consideration in making your judgment?

E-mail Question:

Some companies make performance evaluation and bonus adjustments to protect managers from the harmful effects of many uncontrollable factors. Other companies make no such adjustments. Is one of these approaches clearly inferior, or is this just a "management style" choice?

Session 16

Topic: Performance Evaluations (Preparation for Group Project #3)

Class cancelled to allow time to work on Group Project #3.

Session 17

Topic: Performance Evaluations (Presentations of Group Project #3)

In the first part of this session, a few randomly selected groups will present the findings of the performance evaluation group project exercise. The assignment and the *Bank of the Desert* database that go with it are posted on Blackboard. In the last part of the class (I hope), an expert class visitor will provide both some reactions about what he just heard you present and some color about how this real-world consulting project unfolded.

Session 18

Topic: Ethical Issues and Analyses of an Industry Application: Retail Brokerage

In this session, we will focus on the management control challenges in the retail brokerage industry. I hope to have an expert guest with us for the class. I have assigned the ethics chapter of the textbook for reading because I want you to be able to identify ethical issues in the cases (and in real life) where they exist. There might be such an issue in the case assigned for this class.

Reading: MV, Chapter 17
Prepare for Class: Case—Philip Anderson

Assignment Questions:

1. What are the proper roles of (a) stockbroker and (2) branch manager? That is, what does the company want them to do? What distinguishes someone who is performing well in each of these roles from someone who is not?
2. What control system does Stuart & Co. use to ensure that the brokers and managers perform their roles well? Is it likely to be effective?

E-mail Question:

Do you see any potential ethical issues in this case? If so, what, and how did you identify it as an ethical issue?

Session 19

Topic: The Role of Controller: Issues and Dilemmas

In this session, we will discuss a case that allows us to consider the role of controller/CFO in a more stressful time.

Reading: MV, Chapter 16
Prepare for Class: Case—Dorothy Rishiek: Experiences of a Controller/CFO

Assignment Questions:

1. Was Dot Rishiek a good controller for Especial Foods? Why or why not?
2. Does Dot have the power to force SCI top management to make a correcting accounting entry? If not, what should she do? If so, should she force the entry to be made, and how large should it be?
3. Are earnings management practices such as took place at Especial and SCI smart? Are they ethical?
4. Does Dot Rishiek have an obligation greater than that of other employees to try to ensure that her corporation acts ethically?

E-mail Question:

All things considered, was Dot Rishiek a good controller for Especial Foods? Did she deserve hearty congratulations and a nice bonus or a boot out the door? Explain briefly.

Session 20

Topic: Control Impacts of Corporate Governance Regulations

In this session, we will focus on the benefits and costs to corporations of the Sarbanes-Oxley Act (SOX).

Reading: MV, Chapter 15
Prepare for Class: Case—Pacific Sunwear of California, Inc.

Assignment Questions:

1. Evaluate the process that PacSun went through to comply with SOX, and particularly SOX Section 404. Was that process as effective and efficient as it could have been?
2. Are the "significant deficiencies" that were identified in each of the two years of the audit evidence of control system flaws or largely irrelevant technical violations? Another way to phrase this question might be: Should disclosure of these deficiencies have had a negative effect on PacSun's stock price?
3. PacSun executives seem convinced that the costs of complying with SOX were greater than the benefits to the company. Why did PacSun not benefit from the compliance process to the same extent as some other companies? Or were their compliance costs too high?

E-mail Question:

Judging now with some benefits of hindsight, was SOX a good law?

Session 21

Topic: Corporate Governance and the Roles of Boards of Directors

In this class, we will focus broadly on systems of corporate governance and the roles and obligations of boards of directors.

Reading: deK, Chapters 1–3
Prepare for Class: Case—Arrow Motorcar Corporation

Assignment Questions:

1. Why did Arrow Motorcar Corporation have a board of directors before it went public? How (if at all) do the legal and moral obligations of private-company directors differ from those of directors of publicly held companies?
2. Evaluate the board composition and actions. All things considered, did the board act properly? Did the board members choose the optimal time to terminate Billy Ray Repko?
3. What should the board members do now (March 22, 2016)?
4. What could have prevented or minimized the problems that Arrow faced?

E-mail Question:

If the Sarbanes-Oxley law had been passed before the time of this case, do you think the problems faced by the board of Arrow Motorcar Corporation would have occurred? Explain.

Session 22

Topic: Fiduciary Obligations Related to Executive Compensation and Other Governance Issues

In this class, we will discuss the fiduciary obligations related to executive compensation. Our guest for the day (I hope) will be Michael Ziering, the now-retired Chairman/CEO of Diagnostic Products Corporation (DPC). Michael has both a legal background and experience with issues such as those described in the case assigned for the day. I have asked Michael also to give you some perspective on the Foreign Corrupt Practices Act and the difficulties DPC faced in complying with that Act after we discuss the Golden Parachutes case.

Reading: deK, Chapters 8 and 9
Prepare for Class: Case—Golden Parachutes?

Assignment Questions:

1. If the proposed severance agreement is implemented, who benefits and who loses?
2. Should the compensation committee approve the severance agreement as is? Should some of the elements of the agreement be modified? Or should DTI not have a severance agreement?
3. Suppose that you, as Dennis Feingold, object strongly to at least some of the elements of the severance agreement but that the other two members of the DTI compensation recommend adopting the agreement as it is written. Would it be worthwhile for you to voice your objections forcefully and, perhaps, to take the issue to the full board of directors? Or would you consider it adequate just to cast a negative vote when the issue comes up in the compensation committee?

E-mail Question:

Are there any ethical issues in this case? If so, what? What makes them ethical issues?

Session 23

Topic: "New" practices: Enterprise Risk Management

Our focus in this session is on enterprise risk management, a newly developing tool aimed at helping companies address all the various kinds of risks they might face.

Reading: deK, Chapter 6, particularly pp. 107–108, and Appendix C
Prepare for Class: Case—Entropic Communications, Inc.

Assignment Questions:

1. Why did Entropic implement a formal enterprise risk management (ERM) process?
2. Do you think the company realized the benefits of ERM as envisioned by COSO? Why or why not?
3. What changes would you suggest for making the ERM process at Entropic more effective?

E-mail Question:

ERM is currently one of the hot topics in management. Virtually every company is looking at the technique and deciding whether and how to use it. Do you think the ERM technique is a fad that will soon disappear or an improvement that will provide enduring benefits to a broad range of companies?

Session 24

Topic: "New" practices: Going "Beyond Budgeting"?

In this session, we will examine the "planning and budgeting system" of a company that has gone "Beyond Budgeting." This approach is still relatively rare. Is it superior to what most companies do and, hence, an innovation that will spread? Or is it a fad that will soon die out?

Reading: Go to the Beyond Budgeting Institute website (www.bbrt.org). Read some of the key materials in the sections titled "About" and "Resources."

Prepare for Class: Case—Statoil

Assignment Questions:

1. Statoil managers claim that their company no longer prepares a budget. What do they mean by that claim?
2. Why did Statoil decide to abandon budgeting?
3. Describe the new processes that Statoil implemented to replace the budget. What are its strengths and weaknesses?
4. Is the Statoil "Ambition-to-Action" system just a routine implementation of the Beyond Budgeting approach, or does it include some additional features or fail to uphold some of the Beyond Budgeting principles?
5. The "Beyond Budgeting" approach is still relatively rare outside Europe. Why? Is there something about non-European cultures that limits its applicability, or are other companies just slow to catch on to an innovation that has started in Europe?

E-mail Question:

Instead of placing sometimes exclusive emphasis on the achievement of budget targets, as they claim to have done, and possibly still do, in banks, for example, should firms go "beyond budgeting"?

Note: I expect Bjarte Bogsnes, a key character in the Statoil case, to join us in class today. You can see Bjarte's new book called *Implementing Beyond Budgeting* promoted on the bbrt.org website. Bjarte is Chairman of the Beyond Budgeting Institute in Europe and a leading expert on this topic. We will indeed be fortunate to have him with us in class if he can arrange his travel from Norway.

Session 25

Topic: Industry Application: A Billing Scorecard

In this class, we will discuss an innovative result-control approach to solution of a problem that is usually addressed with development and enforcement of sets of policies and procedures.

Prepare for Class: Case—Game Shop, Inc.

Assignment Questions:

1. Why was GSI's production quality control performance so much better than its billing performance?
2. Evaluate the billing improvement effort and each of the elements of the system that emerged. Comment specifically on the billing scorecard, detention meetings, P-CARs, and any other system elements that you believe are relevant.
   a. In considering the scorecard, be sure to address the following questions: What are the Scorecard and each of its measures trying to accomplish? Are these the right measures? Does each measure add unique value? Are the measures weighted appropriately in importance? Are the business unit grades generally consistent across measures? Can any of the measures be distorted or gamed?
   b. Do you believe that David's improvement efforts will close the gap between production and billing performance enough to meet project goals? Explain?
   c. Do you have any suggestions to improve the billing process? Explain.
3. GSI's ultimate goal is "perfection." Can this system be used to achieve billing perfection as it is designed, or will changes have to be made, or might even a totally different approach be necessary? Explain.
4. The Billing Scorecard is a result-accountability approach to address the problem, chosen because this company's culture is "metrics centric." What are the advantages and disadvantages of using a result-accountability approach? What other alternatives might have been used to solve the problem?

E-mail Question:

Would you include billing performance among a short list of "critical success factors" for GSI? If so, why has it apparently not received much attention from management up until now? If not, why all the concern now?

Session 26

Topic: Industry application: A Hedge fund

In this class, we will discuss issues related to performance evaluation and incentive compensation in a hedge fund. Our primary focus will be on the role of the hedge fund analysts.

Prepare for Class: Case—Raven Capital, LLC

Assignment Questions:

1. Assume the role of a Raven portfolio manager who has to allocate a bonus pool to the four analysts working primarily for him. Assume a 20% incentive fee for Raven. Use 30% of the incentive fee as the bonus pool to be allocated to the four analysts whose backgrounds and 2009 portfolio performances are described in Assignment Figures A and B (posted separately on Blackboard).
   a. How would you allocate bonuses to these four analysts? What alternatives did you consider? Why did you make the choices you did?
   b. Is there any other information you would like to have had available before making your decisions? If so, which?
   c. Do you think you should pay out the entire bonus pool this year, or hold some money in a "bonus bank reserve"? Why or why not?
   d. Should the proportions of the bonuses allocated vary depending on the size of the bonus pool available? Redo the allocations of the bonus pool to these four analysts assuming that because of a high water mark constraint, the incentive fees earned in 2009 were only $300,000.

2. Evaluate the Raven performance evaluation and incentive compensation system. What changes would you recommend, if any?

E-mail Question:

Employee compensation levels in this industry are higher than in most other industries. Is this high compensation justified, or is it evidence of one or more flaws in the corporate governance system? Explain.

Session 27

Topic: Industry Focus: Health Care

In this class, we will try to apply the knowledge we have gained in the earlier sessions to a challenging setting—control of doctors in a family medical practice.

Prepare for Class: Case—Family Care Specialists Medical Group, Inc.

Assignment Questions:

1. What purposes are served by the FCS physician compensation system? Must some of the compensation be made performance-dependent?
2. Is the current system an improvement over the QIIP that it replaced? Explain why, listing the major strengths and weaknesses of both plans.
3. Are the incentives provided by the existing system "balanced" or are some forms of initiative rewarded more generously than others? In particular, compare the average reward for seeing additional patients during regular sessions to that for seeing additional patients during "extra" Saturday sessions. How might the existing system affect FCS physicians' allocation of effort?
4. What are the major constraints on the design of any physician compensation system for FCS? In particular, how should FCS decide the appropriate reward, if any, for higher performance?

5. What changes to the FCS physician compensation system, if any, would you recommend to Dr. Samaniego?

E-mail Question:

Is management of doctors somehow different? In particular, should we expect doctors to respond to performance-dependent incentives like most corporate employees do, or do they have other, perhaps mostly nonpecuniary, motivations?

Session 28

Topic: Management Control in Not-for-Profit Organizations

In this session, we will discuss some control issues in a setting with which you all have some familiarity—USC.

Reading: MV, Chapter 14
Prepare for Class: Case — University of Southern California: Responsibility Center Management System

Assignment Questions:

1. Using the terminology that we used in this course, what would you call USC's responsibility centers? Are they revenue centers? Profit centers? Something else?
2. The RCMS seems to be working reasonably well. USC has used it for over 25 years, and seemingly nobody wants to abandon it. What makes it effective?
3. Consider each of the criticisms of RCMS:
   a. Does it sound plausible that the RCMS could have been causing, or at least contributing to, the problems if, indeed, there were problems?
   b. Which of the problems have been solved by the RCMS refinements that were implemented over the years? Which remain?
4. What should be done now? Does the RCMS create "perverse incentives"? If so, how? If not, why not?

E-mail Question:

Very few colleges and universities use a decentralized responsibility center system like RCMS. If RCMS provides USC with a comparative advantage, why haven't more universities implemented something like it? Conversely, if RCMS is an inferior system, why has USC used it for so long?

Model Syllabus 4

Management Control Systems (Evening)

Text K. A. Merchant & W. A. Van der Stede, *Management Control Systems: Performance Measurement, Evaluation, and Incentives* (Pearson).

Course Objectives

This graduate course is designed to broaden and deepen your conceptual and technical understanding of management control systems (MCS). MCS are considered broadly to include everything that managers do to ensure good performance or, more specifically, to ensure that the company's strategies get implemented effectively. But the emphasis in the course is on *financial controls*, which dominate in importance at managerial levels in all but the smallest organizations. Using financial controls requires managers to make decisions about: (1) responsibility structures (e.g., cost centers, profit centers), (2) performance measures (e.g., market, financial, and/or nonfinancial measures and their combinations), (3) performance evaluations, which take into consideration performance targets or other benchmarks, and (4) rewards (including performance-dependent compensation).

The course is issue-oriented, with current and emerging issues as a major focus. Among the issues we will discuss are control uses of measures such as EVA, EBITDA, and customer satisfaction, dashboards and Balanced Scorecards, the "stress-testing" use of financial plans, the "Beyond Budgeting" movement, various uses of stock-based compensation, the control implications of the Sarbanes-Oxley Act of 2002, enterprise risk management, and corporate governance.

The course is built around a textbook—Merchant and Van der Stede's *Management Control Systems*. The text is supplemented with a short monograph (de Kluyver's *A Primer on Corporate Governance*):

(MV) K. A. Merchant & W. A. Van der Stede, *Management Control Systems* (Pearson).
(deK) C. de Kluyver (2009), *A Primer on Corporate Governance* (Business Expert Press).

Some additional materials also will be distributed on Blackboard.

The focus of most of the classes will be on discussions of cases. The readings are intended to provide background that is useful for informing the case discussions. For each case assignment, I will provide some Discussion Questions. These questions are intended to help frame and focus your reading and consideration of the course materials. In a number of the classes, I will invite a practitioner visitor to class to add expertise and to bring the topics "to life."

Projects

The projects will involve group analyses of cases that are supported by data provided on Excel spreadsheets. The first project is a budget "stress testing" exercise. The second involves comparative performance evaluations of a large number of bank branches. Some groups will be asked to present their analyses and conclusions in class.

Students can form their own working groups, but I will help if needed. The optimum (and maximum) group size is four. I will accept groups as small as three. As part of the grading process, I will ask students to grade each of their fellow group members. This is done to try to reduce the "free-rider" effect.

Grading

Project 1		50 points
Project 2		50 points
Class participation		50 points
Final exam		100 points
	Total	*250 points*

Class Participation

I assign a material proportion of the grade based on **class participation** for several reasons. First, it improves my grading accuracy. I think I can learn more from hearing you share your ideas in a long series of classes than I can from reading what you write in a few short exam sessions.

But perhaps more important than that, grading class participation motivates class participation, and having highly interactive class sessions helps the learning process. Active class participation encourages students to be well prepared and thus to become active, rather than passive, learners. Participation provides students with the opportunity to gain from the experiences and talents of everyone in the class. And class participation helps students improve their oral communication skills. This is important because research shows that people in business tend to spend very little time reading and even less time writing reports. A great deal of managers' and other professionals' interactions with others are through oral communication.

Class participation evaluation will be based primarily on the quality of the participation in classroom discussions. To be clear on what I am looking for regarding class participation, and to further aid in your preparation, I have listed below some characteristics of effective class participation:

(1) Does the class member make points that are especially pertinent to the discussion? Do they increase the understanding of the class or are they simply a regurgitation of the problem or case facts?

(2) Is there continuity in one's contribution from what has been said previously during class, or are the comments disjointed, isolated, or tangential? The best class contributions are those that reflect not only excellent preparation, but also good listening, interpretive and integrative skills.

(3) Do the comments reflect a willingness to put forth new, challenging ideas or are they always agreeable and "safe"?

(4) Is the participant able and willing to interact with others by asking questions, providing supportive comments or challenging **constructively** what has been said?

Participation will be evaluated based on a near-continuous scale, the end points of which can be described as follows:

Outstanding Contributor: This person's contributions reflect exceptional preparation, and the ideas offered are always substantive and provide major insights and direction for the class. If this person were not a member of the class, the quality of the discussions would be diminished significantly.

Unsatisfactory Contributor: This person may be absent from class or someone who rarely participates in class discussion. Alternatively, this person's contribution in class reflects inadequate preparation and/or understanding. Ideas offered are not substantive and provide few, if any, insights and never a constructive direction for the class. Integrative comments and effective arguments are absent. Class comments are either obvious, isolated from the main discussion, or confusing to the class.

Final Exam

The final exam will test **individual** (not group) work. The **final exam** will be a take- home exam in lieu of an exam during the final exam period.

E-Mail Questions

On the bottom of many of the class assignments, you will see that I have included an "e- mail question." Prior to noon before each of our classes, please send me an e-mail message or private Blackboard posting answering the question(s) for that day's class. This is not intended to be a time-consuming obligation. Your answers should be brief—**three sentences or less** for each question.

Your answers to the e-mail questions serve multiple purposes. First, they help me to get to know you and how you think. Second, these messages open the communication channels between us. Since you have to send me a message, it is easy to append another thought. In the past some students have used this opportunity to ask a question on another topic or to give me some feedback about the course. I welcome this. Third, your e-mail answers help me orient the class discussion. For example, they help me both to judge the mindset of the class and to find people with unique perspectives. Finally, the questions are functional because they encourage good advance preparation. The regularity with which you input your e-mail question answers on a timely basis and the quality of your answers will form part of your participation grade.

Schedule of Classes

Week 1

Topic: The Control Function of Management

In this first session, we will go over the syllabus and get to know each other. Then I will provide a general lecture on managers' control options. Finally, we will discuss some control vignettes and a case.

Reading: MV, Chapters 1–4
Prepare for Class: Case—Atlanta Home Loan

Assignment Questions:

1. Identify the devices (controls) that Al Fiorini used to control his business both before and after he went back to school. Classify each control as a result, action, or personnel or cultural type of control.
2. What went wrong? Did Al use the wrong types of controls? Did he use the right types of controls but fail to design or implement them properly? Or was he just unlucky?
3. What should Al Fiorini do now? Why?

Week 2

Topic: Result Controls

In the first part of the class, we will discuss a control system evaluation case which illustrates the control system used in a field service engineer (FSE) setting. The case is particularly interesting because the company, Diagnostic Products Corporation (DPC), is in the midst of a significant change. Formerly, company managers controlled FSE inputs—they paid FSEs for hours worked. Now they are attempting to measure FSE outputs, or results, and to provide performance-dependent compensation.

In the second part of the class, we will examine and critique the performance measurement and incentive systems in two companies in an industry with which all of you have some familiarity—automobile retailing. The two companies' systems are quite different. Can we say which one is the better design? What might explain the differences?

Reading: MV, Chapters 5, 6, and 9
Prepare for Class: Cases — Diagnostic Products Corporation (DPC)
Puente Hills Toyota
Kooistra Autogroep

Assignment Questions:

Diagnostic Products Corporation (DPC)

1. Evaluate the design of the DPC Performance Bonus Program for U.S.-based field service engineers (FSEs) as it currently exists and the way in which the Program is being implemented.
2. What changes would you suggest, if any?

Assignment Questions:

Puente Hills Toyota and Kooistra Autogroep

1. Compare and contrast the performance measurement and incentive systems used at Puente Hills Toyota and Kooistra Autogroep.
2. When comparing the use of incentives in the two companies, do you believe that incentive pay is truly effort-inducing; that is, does it drive employees to perform at their best? If you believe incentive pay is not, in whole or in part, effective in making employees work harder, then what other potentially useful purposes does variable incentive pay provide for organizations relying on it, if any?
3. What advice would you provide to the managers of these companies?

E-mail Question:

As a first approximation, which of the following statements do you believe is most correct, and why:

(1) People are people. They respond approximately equally to many things, including incentive systems.

(2) To work well, a company's incentive systems must be tailored in many ways to fit the specific desires of various employee groups.

Week 3

Note: The names of the individuals working on the two group projects are due to me by the start of this class. The optimum (and maximum) group size is four. Groups of three are permissible. Please have a representative send me an e-mail message with the names of the individuals in your group.

Topic: Financial Responsibility Structures and Problems Caused by Interdependence

The focus of the first part of this session is on one of the main management control system choices—design of the organization's authority and financial responsibility structures. Some of these choices create organizational interdependence—products or services are provided by one organizational entity to another. Interdependence, in turn, often creates cost allocation or transfer pricing problems. In the second part of this session, we will discuss a representative example.

Reading: MV, Chapter 7
Prepare for Class: Cases — Kranworth Chair Corporation
Zumwald AG

Assignment Questions:

Kranworth Chair Corporation

1. Identify the most important key recurring decisions that must be made effectively for KCC to be successful. In KCC's functional organization, who had the authority to make these decisions? Who has the authority to make these decisions in KCC's new divisionalized organization?
2. Did KCC top management go too far in decentralizing the corporation? Did they not go far enough? Or did they get it just right? Why?
3. Evaluate KCC's new performance measurement and incentive system. Assuming that KCC will retain its new divisionalized organization structure, what changes would you recommend, if any? Why?
4. Assume that the R&D function is to be decentralized (given to the divisions). Would this necessitate changes to KCC's performance measurement and incentive system? If so, which and why? If not, why not?

Assignment Questions:

Zumwald AG

1. What sourcing decision for the X73 materials is in the best interest of:
   a. The Imaging Systems Division?
   b. The Heidelberg Division?
   c. The Electronic Components Division?
   d. Zumwald AG?
2. What should Mr. Fettinger do?

E-mail Question:

Is a transfer price just a cost allocation with a profit margin tacked onto it? Explain.

Week 4

Topic: Budgeting or "Beyond Budgeting"

Planning and budgeting processes are important, and often complex, elements of companies' management control systems. Most firms beyond minimal size, but not all, engage in often extensive planning processes, the annual component of which is called budgeting. The Mainfreight case that we will discuss in the first part of this class, however, illustrates the functioning of a large, successful international logistics company that does *not* engage in an annual budgeting process. The goal in this case is to think about what budgeting is, and what it is not, and how Mainfreight can succeed without having a budget, which is a control system element that most companies think is essential. One of the key points of discussion of this session, therefore, is to consider whether there are valid, effective alternatives to budget-based performance management systems, and if so, whether these really are what they claim to be or just budgeting processes under a different guise?