



ASEAN WORKSHOP Accounting and organisations

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Wednesday, February 14, 2024

	Topic	Venue	Host
9:00 – 10:30am	Intro - Accounting and organisations	MZ05-06	ML
10:30 – 11:00 am	Morning tea	MZ05-06	
11:00 – 12:00 am	Budgets intro	MZ05-06	ML
12:00 – 1:00 pm	Lunch	MZ05-06	
1:00 – 2:15 pm	Advanced budgets & behaviour - Part I	MZ05-06	ML
2:15 – 2:30pm	Tea break	MZ05-06	
2:30 - 4:00 pm	Advanced budgets & behaviour - Part II	MZ05-06	ML

Accounting and organisations

Within organization we focus on management accounting:

“Techniques and processes that are intended to provide financial and not-financial information to people within an organization to help them make better decisions and thereby achieve organizational control and enhance organizational effectiveness”

Organisational Control

- “The process of ensuring that the organization is pursuing courses of action that will enable it to achieve its purpose”

A Framework

Customer Needs

Technological Change

Globalization

Strategy for Customer Value

Product / Service Innovation

Quality / Low Cost

Planning Decisions
Product/Service Design
Production and Delivery
Customer Services

Control Decisions
Responsibilities
Performance Measures
Compensation

Customer Value

Organizational Value

Subaru Finally Has an SUV That's Good for the Great Outdoors

Subaru's shift stands out especially because of the bizarre stance it took on electric vehicles just a few years ago. Bloomberg NEF's Nat Bullard pointed me toward Subaru's corporate social responsibility report for 2018, which contains this absolute gem:

- On the other hand, AWD [all-wheel drive], which is a major strategic vehicle 90% of which Subaru is introducing to the market, has **a great opportunity to cope with recent climate change**, compared to FW [front-wheel] and FR [rear-wheel] automobiles of 2WD [two-wheel drive]. The main reason for this is that traveling stability unique to AWD is **very good compared to 2WD on rough road after torrential rain and snowy road surface due to heavy snowfall**. There is a possibility that the recognition that it is an automobile that can run safely and with peace of mind expands and leads to an increase in sales opportunities.

[Subaru Finally Has an SUV That's Good for the Great Outdoors – Bloomberg](#)

Planning / Decision Making and Control

Planning Decisions

- Decisions about what tasks should be performed and how to complete those tasks.
- Long-term decisions tend to be made by top-level managers.
- Short-term decisions tend to be made at lower levels of management.



Control Decisions

- Decisions relating to managing, motivating, and monitoring individuals within the organization.
- Proper organizational design and assignment of responsibilities help control decisions of members of the organization.
- Control includes the choice of performance measures.

Control Decisions

Management accounting helps making control decisions by:

- Developing a reward system based on accounting numbers.



My performance evaluation is based on the accounting profits of my division.

And boy, I did well!

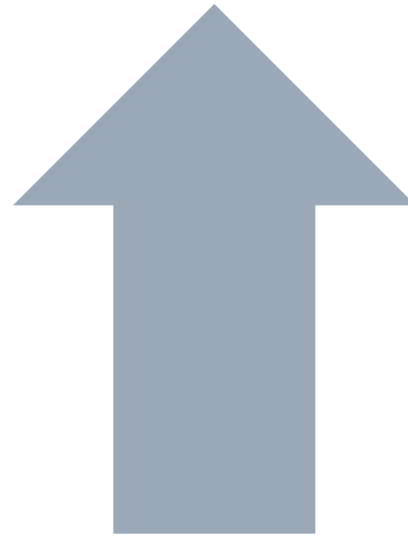
- Management accounting assists in control by limiting employees' actions based on accounting numbers.

If a return is for \$50 or more, I must get a manager's approval.

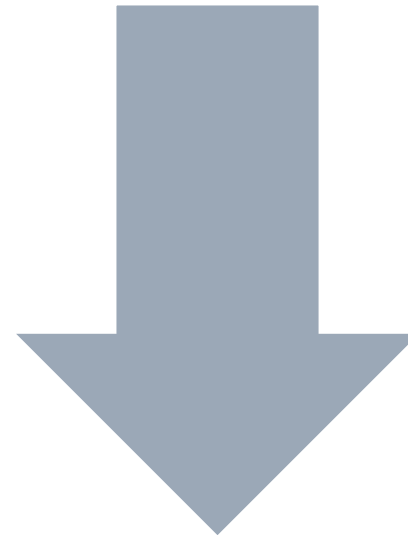


An important Trade-off

Throughout the course I will assume that the best decisions are made with the best information available. But ...



... the best information is sometimes located at lower level (specialist) staff members.



For decision making this information has to be transferred to higher level managers.

Example: Management accounting, incentives

For decades, the Federal Aviation Administration has grounded pilots dealing with depression or other mental diagnoses, with policies so strict that the decision to seek psychiatric help or a prescription for standard antidepressant medication is enough to trigger a suspension of their flight eligibility. It is a system that has left many pilots, including Mr. Emerson, to struggle largely alone.

“A lot of us aren’t as forthcoming as we otherwise would be,” Mr. Emerson said.

From “Is This Hell?’ The Pilot Accused of Trying to Crash a Plane Tells His Story.”



An important trade-off

Higher level managers will use the information to make the best decision (**decision making**) AND to evaluate the lower-level manager (**control**).

If a management accounting system focuses merely on **evaluation and control**:

- then lower-level managers will distort the information flow. **This frustrates decision making.**

If a management accounting system focuses merely on **decision making**:

- Lower-level managers will give excellent information. But there will be a **loss of control** (= value destruction)
- Why? Anarchy ensues.

Three important parameters that affect the outcome of the trade-off: Responsibilities, Performance Measures, Compensation (sometime referred to as: *the incentive structure*)

Organizational architecture

Understanding the role of accounting in organizations.

Ask any CEO what makes running a firm difficult

Most answers will refer to the problems of delegating tasks.

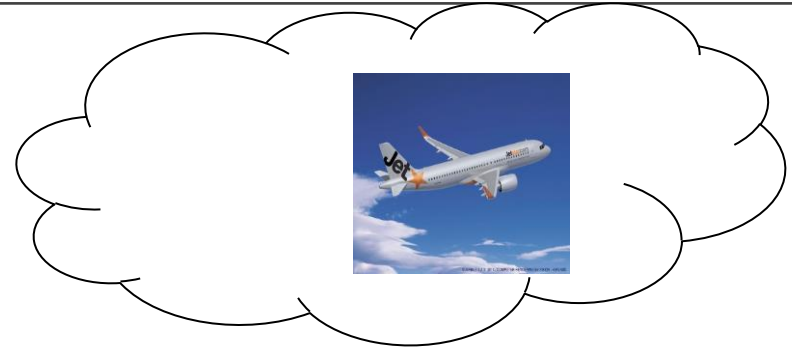
Oh, if only I could run this firm on my own ...

I agree, the economist is right: I'm CEO, not a pilot. That is the concept of specialisation.

But specialisation means delegation of tasks, monitoring people, rewarding them, getting information from them Specialisation is ... costly.



Once you are not alone



Costs of Control go up because of:

- Self-interested behaviour.
- Team production.
- Agency costs.
- Decision rights and rights systems.
- Influence costs.
- Monitoring.



Ideally



Agents:



Agents:



Agents:



Agency problems, examples

Free-rider problem:

Agents have incentives to shirk because their individual efforts are not directly observable.

Shirking in general:

Agents have incentives to minimize efforts. Good outcomes will be attributed to effort. Bad efforts will be attributed to Bad Luck (It wasn't me; it was the other three!).

Horizon problem:

Agents expecting to leave firm in near future place less weight on long-term consequences.

Employee theft:

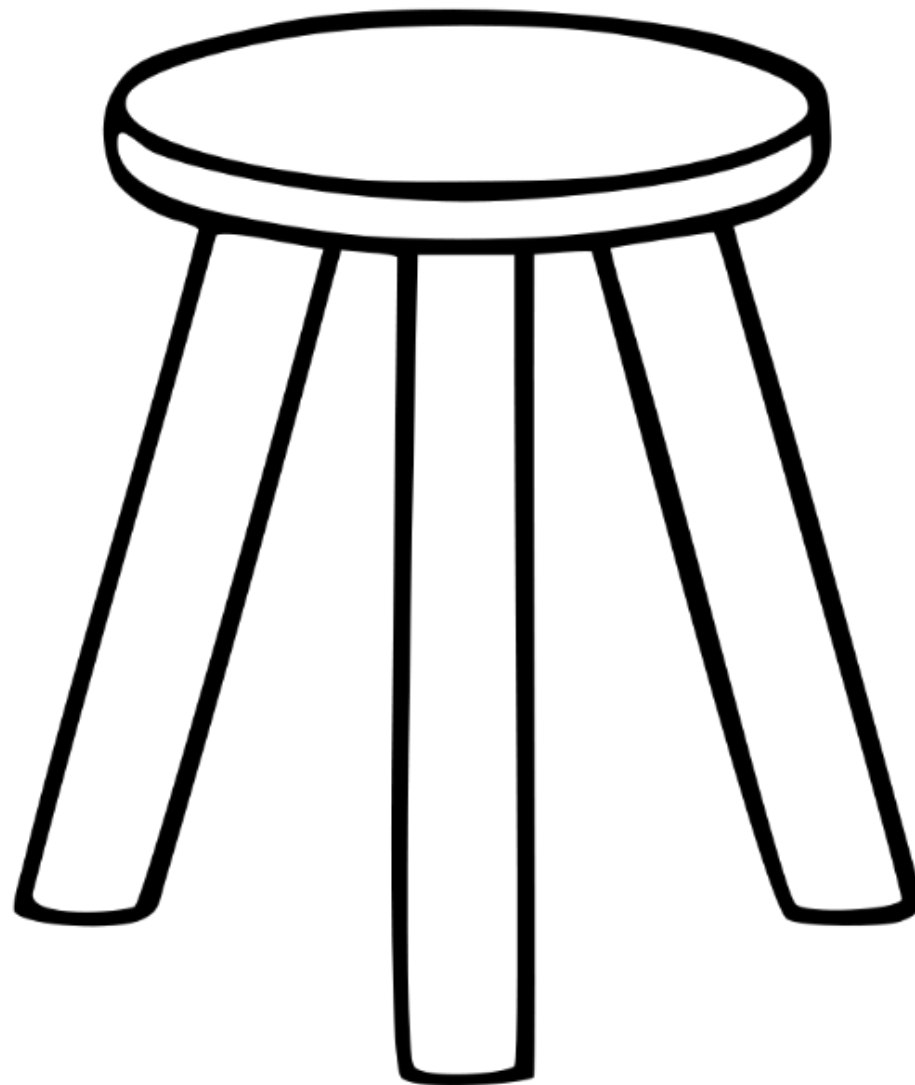
Employees take firm resources for unauthorized purposes.

Empire-building:

Managers seek to manage larger number of agents to increase their own job security or compensation.

Many
problems?

The solution:



The three-legged stool

Organizational architecture depends on three legs:

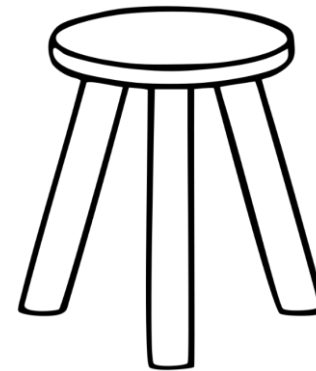
- Partition decision rights: job description
- Measure performance
- Reward and punish performance

In external markets these functions are served by market prices, supply and demand, and the law of contracts.

For transactions inside the firm, management must implement administrative devices to accomplish these functions.

All three legs must be balanced and coordinated: a change in one “leg” requires adjusting the other legs as well.

In doing so the organisation stays in control.



The three-legged stool

Canterbury feral cat hunting competition for kids cancelled after backlash.

Organisers of the annual [North Canterbury Hunting Competition](#) announced the category for the most feral cat kills will be withdrawn, following a public backlash and media coverage. The announcement, posted on social media late on Tuesday, said organisers had been “incredibly disappointed” by the reaction to the new category in the fundraiser, which they say prompted “vile and inappropriate emails and messages sent to the school and others involved”.

It's unclear if there was any link to the competition, which offered hunters aged 14 or younger a \$250 cash prize for the most feral cats killed in North Canterbury over the next two and a half months, as well as a shot at a \$4600 spot prize for junior hunters in the form of a kids motorbike.

Question: regarding this incentive system: what could possibly go wrong?



Formula 409

“I used to run the company that made Formula 409, the spray cleaner. From modest entrepreneurial beginnings, we’d gone national and shipped the hell out of P&G, Colgate, Drackett, and every other giant that raised its head. From the beginning, I’d employed a simple incentive plan based on ‘case sales’: Every month, every salesman and executive received a bonus check based on how many cases of 409 he’d sold. Even bonuses for the support staff were based on monthly case sales. It was a happy time, with everyone making a lot of money, including me.

“We abandoned our monthly case-sales bonus plan and installed an *annual* profit-sharing plan, based on personnel evaluations. It didn’t take long for the new plan to produce results.”

SOURCE: Wilson Harrell, “Inspire Action: What Really Motivates Your People to Excel?” *Success*, September 1995.

Required:

What do you think happened at this company after it started the annual profit-sharing plan?

Formula 409

“About half of my people left the company — and, I might add, they were the best half, my racehorses. They were replaced by recruits from large companies, and gradually, 409 became a little version of a big company — a bureaucratic mess where nobody thought much about case sales. I didn’t want to run a company like that, so I sold it for a bundle and went back to being an entrepreneur and having fun.” (Source: Wilson Harrell, “Inspire Action: What Really Motivates Your People to Excel?” Success, September 1995.)

Decision rights

Decision rights are restrictions on how economic assets of a firm can or cannot be used.

- A waitress cannot sell the restaurant in which she works.
- Employees cannot fire their bosses ... unfortunately ...

Management determines how decision rights are to be allocated among various agents within a firm.

- Ill partitioned decision rights systems can lead to a loss of control, and the resulting destruction of value.
- So, how to do allocate decisions rights correctly?

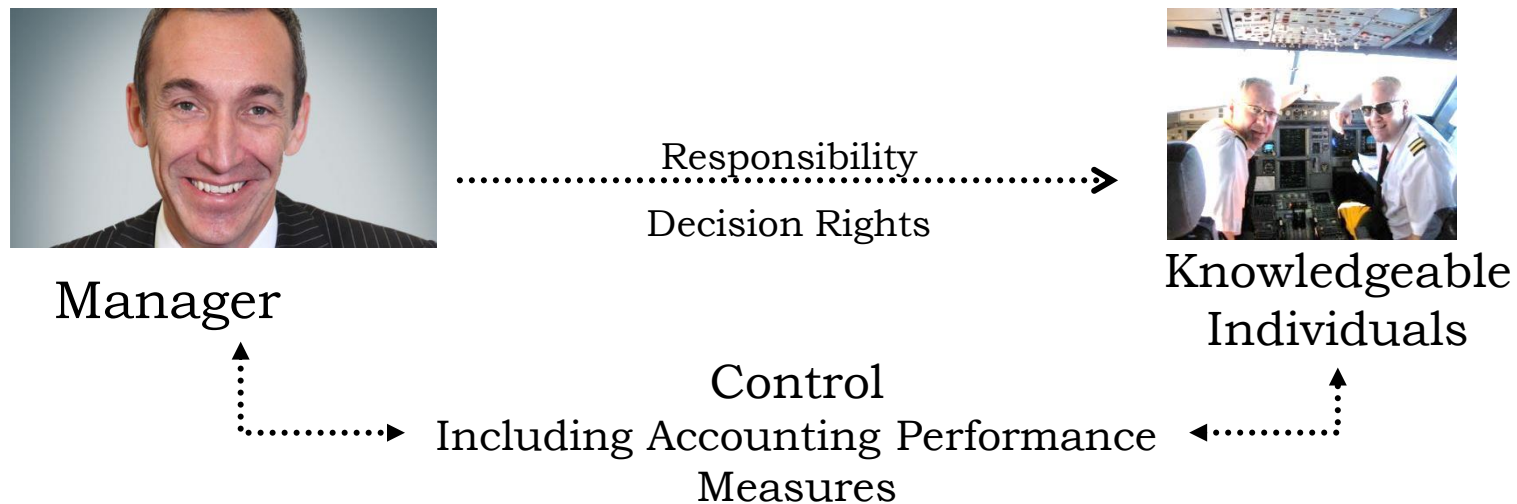
It's about knowledge!

Ideally the firm should link decision making responsibilities to individuals with the best information to make decisions.

However, there is a risk of creating opportunities to destruct value.

Linking knowledge and decision rights is a key issue in organizational architecture.

General rule: when a knowledgeable individual (specialist) has decision rights, then costly control procedures must be added to make sure the individual acts in line with organizational goals.



“Costly control procedures must be added”

- Former bank trader Tom Hayes was sentenced to 14 years in prison after a London jury convicted him of trying to fraudulently rig the London interbank offered rate, or Libor.
- Jerome Kerviel of Societe General. Kerviel “had taken massive fraudulent directional positions in 2007 and 2008 far beyond his limited authority.” The resulting loss was just below 5Bn Euros.



Linking decision rights to knowledge

Knowledge and decision rights linked within one person:

- Apparently Agent 007 has a licence to kill ...
- Which costly control procedures apply to someone like James Bond?



Decision Rights and Information Transfers

An important factor determining the allocation of decision rights is the ease with which one can transfer knowledge between individuals.

Non-complex information can be easily transferred.

- separate the decision maker from the knowledgeable person.

Complex information cannot be easily transferred.

- Requires costly control systems

Decision Rights and Information Transfers

Non-complex information can be easily transferred.



Decision Rights and Information Transfers

Non-complex information can be easily transferred.

- This allows separating the decision maker from the knowledgeable person.

Customer and salesperson,
what do they discuss: complex
or non-complex information?



Salesperson and his manager,
what do they discuss: complex or
non-complex information?

Decision Rights and Information Transfers

Complex information cannot be easily transferred.

- Requires costly control systems



I am here to
buy a nice
painting ...
and not pay
too much.

Vanderschmidt's

Jan Vanderschmidt was the founder of a successful chain of restaurants located throughout Europe. He died unexpectedly last week at the age of 55. Jan was sole owner of the company's common stock and was known for being very authoritarian. He made most of the company's personnel decisions himself. He also made most of the decisions on the menu selection, food suppliers, advertising programs, and so on. Employees throughout the firm are paid fixed salaries and have been heavily monitored by Mr. Vanderschmidt. Jan's son, Joop, spent his youth driving BMWs around the Netherlands and Germany at high speeds. He spent little time working with his dad in the restaurant business. Nevertheless, Joop is highly intelligent and just received his MBA degree from a prestigious school. Joop has decided to follow his father as the chief operating officer of the restaurant chain. Explain how the organization's architecture might optimally change now that Joop has taken over.

Joop does not have the same level of specific knowledge to run the company as his father. Rather the specific knowledge is likely to be held by other people throughout the company. Given this distribution of knowledge, Joop will probably have to decentralize decision rights. Decentralizing decision rights will require associated changes in the performance-evaluation and reward systems (so that the three legs of the stool balance). Joop will probably want to increase the emphasis on performance-based pay to motivate the newly empowered workers to make decisions that are in the best interest of the company.

P 4–8: American InterConnect I

Employee satisfaction is a major performance measure used at American Inter Connect (AI), a large communications firm. All employees receive some bonus compensation. The lower-level employees receive a bonus that averages 20 percent of their base pay whereas senior corporate officers receive bonus pay that averages 80 percent of their base salary. Bonus payments for all employees are linked to their immediate work group's performance on the following criteria: income, revenue growth, customer satisfaction, and employee satisfaction. Managers can have these criteria supplemented with additional specific measures including hiring targets and some other specific objective for each manager such as meeting a new product introduction deadline or a market share target.

Employee satisfaction usually has a weight of between 15 and 20 percent in determining most employees' overall bonus. To measure employee satisfaction, all employees in the group complete a two-page survey each quarter. The survey asks a variety of questions regarding employee satisfaction. One question in particular asks employees to rate how satisfied they are with their job using a seven-point scale (where 7 is very satisfied and 1 is very dissatisfied). The average score on this question for all employees in the group is used to calculate the group's overall employee satisfaction score.

Required:

Describe what behaviors you would expect to observe at AI.

Allied Van Lines

Why are drivers for long-haul (cross-country) moving companies (e.g., Allied Van Lines) often franchised, while moving companies that move households within the same city hire drivers as employees? Franchised drivers own their own trucks. They are not paid a fixed salary but rather receive the profits from each move after paying the franchiser a fee.

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Long-haul truckers are much more difficult to monitor because they spend considerable time on the road by themselves. The only observable behavior is whether they make timely deliveries. Truck failures and wasted time on the road can lead to untimely deliveries. If the company owns the truck, the truck driver can blame the company for poor maintenance. If the truck driver owns the truck, then the trucker is responsible for truck maintenance and failure.

Inner-city truckers are easier to observe, and the company can perform maintenance of trucks daily.