

# Airtex aviation – cost control study case

[Environment](#), [Air](#)



Two managers recently graduated purchase Air Tex Aviation, a firm on the verge of bankruptcy. In front of the discrepancies of the current control system, Ted Richards and Frank Edwards decide to implement a system which improves transfer pricing, cost allocation and autonomy. Therefore, this case wonders about the difficulties to implement it and the steps to change the management style.

What appears to be the problem in Air Tex is linked to business which is linked with the state of mind of the staff: there is a lack of motivation. The company is on the verge of bankruptcy because of Sarah Arthur's accounting system and accounting statements. We know that it is a problem because of the self-interested behavior of Sarah Arthur in the company since 20 years. She monopolizes the decisions and the power.

The issues of autonomy, cost allocations and transfer pricing are those which have an important impact on Air Tex profitability and its strategic vision. The issue for Ted and Frank, future managers of Air Tex is to establish a growth over the long-term for the firm with a new strategic view. The problem statement can be summarized as follows:

How can Air Tex grow in the first five year-period?

Data analysis

There are a number of issues before Franck and Ted set up the decentralized control system, which will be analyzed now.

First, there were problems for Ted with the accounting department: over importance of the accountant Sarah Arthur, inexistence of accounting

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system, a non-clear and defined financial statements, retention of information, great power in the same hands and lack of management skills. It provoked a lack of information for the departments and of a motivation because they are not involved in the decision making process. Decisions are taking arbitrarily, without the search of a consensus.

Then, Ted felt a problem linked to the personnel work ambiance, their seriousness and more over their professionalism. This entails again a lack of information and motivation, important causes of the issue. There is also a lack of innovative spirit, because staff is for a long time in the company and there is no turnover or flexibility, which don't encourage him. There is a static hierarchy, without possibility of evolution.

Ted and Frank faced a problem when they take decisions of acquiring the company because of a lack of skills: they have a poor knowledge about the aviation business and structural errors were made in the projections (running out of money for the end of the year). Then, there is a difficulty to understand the accounting system and the economical situation is exigent. Indeed, the figures in the balance sheet for Air Tex aviation appear to be very disorganized. Cost allocation for the accounting department and the volume of expenses are not very justified (\$392, 350). Moreover, all the departments have a negative net income except the fuel line activity which employed unskilled employees. We notice that inventory is a budget item too much important, mainly aircraft inventories (515, 000\$) which will not enable to invest in the future.

Key Decision Criteria

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We saw the different issues about the old management control system. To change it and implement a new system, Ted Richards and Frank Edwards took few key decisions on:

#### The strategic view

With new owners, the strategic view of AirTex Aviation must be redefined. Because the firm is near of the bankruptcy, Ted and Franck design a new long term strategy which reduces costs, decentralizes management decision process; implements new management styles and defines clear way to growth and move in the aviation market.

#### The objectives

One of the first steps is to identify Specific, Measurable, Acceptable, Realizable, and Timetable objectives at each level of the enterprise (divisional and top level). At the top level, one of these new objectives is to improve profitability of 20% on the next five years and increase return on investment rate. The goal is to make objectives in correlation with the management decision process. Other intention is to work with a cost control system, more efficient than easy to implement, in order to change the current financial situation of the firm.

#### Corporate Governance

One of the most important decisions is to decentralize management decision. This resolution suggests limiting the power of the accountant. Each divisional manager will be more autonomous and can directly impact their

future performances. The decentralization of the decision process is a good way to facilitate it and help to develop relationship between stakeholders and staff.

### Moral

Each division is an autonomous profit center. Each divisional manager has the possibility to take decisions on labor, supplies and material, product mix and selling price of his department's product. This decision right is a variable to affect the moral of the managerial team and motivate them. It's a start for an incentive program.

### New control system implemented

With the new control system, the leadership is divided between Ted Richards and Frank Edwards as equal partners and as best friends and they try to encourage staff to take desirable actions by decentralizing the power and involving the staff.

The objective of the two partners was to look younger the management of Air Tex, to create a new control system provision support and information needed, and to lower the power of the accountant Sarah Arthur. We are going to analyze the advantages and the disadvantages of this new control system.

### Advantages:

First, the new control system aims at providing accurate financial information to each divisional manager in order to encourage managers to

make all the decisions themselves, by creating a feedback of their operations. To motivate managers, there is also the creation of incentives for managers: they can receive a bonus of 10% of their profit centres profit

Another source of motivation for the departments consists in offering them to manage cash by giving them receivables: the new management control system gives them a credit granting authority, a responsibility for collections and systems of charges for delay payment.

Furthermore, autonomy is the capacity to act by oneself and it's an inner freedom, and ability to choose oneself to increase the motivation of managers. Its autonomy is strengthened because managers can hire, fire and manage the salary schedule.

The new management control system modifies the transfer pricing, which refers to the pricing of assets, services and funds that transferred within an organization. It's simply the act of pricing of goods and services or intangibles when the same is given for use or consumption to a related party ».

1 So, it's the price at which products or services are transferred between profit centres or subunits, which affects the allocation of the total profit among the parts of the company. There can be internal (motivate managers and monitor performance) and external (taxes or tariffs) reasons for transfer pricing. So, it decentralizes operations to make each activity a profit centre and group them by departments. It's a typical Activity Based Costing (ABC) method with a new cost allocation, which consists in determining the cost of services provided to users of that service. Each department is responsible of its results, revenues and

### Disadvantages:

However, some disadvantages and disturbances can result from the implementation of this new management control system. The latter need to reduce three basic issues: lack of motivation, lack of direction and personal limitations.

First, Frank Edwards and Ted Richards didn't know the aviation business, when they made the choice of the purchase. They didn't have the knowledge and the time to analyze results. Furthermore, they implemented a very changing control system without having time to train people. They need a lot of time to educate divisional managers and it requires a deep change in the management skills. To move from a system where they are assisted and have without responsibility to a system which gives them more autonomy, take a long time. That observation explained the controversy which appeared about the management of receivables by the divisions.

Furthermore, divisional managers are out of control, because incoming cash will be managed by " amateurs". So, an important information control is necessary to improve the reliability of Daily Department Reports. In fact, divisional managers don't have the skills to draft accounting statements.

There is also an issue to implement the new accounting system, because Sarah Arthur decided to limit her work in the company and they hire a new accounting clerk without experience. So, there is a difficulty to understand how Sarah Arthur built the financial statement and to replace an employee with an important role in the functioning of Air Tex. So, Ted Richards and Frank Edwards need to be very adaptive and proactive.

Finally, this new control system requires some additional costs, because each department can hire a new employee to deal with the Daily Department Report. There is also to educate staff by creating seminars of information, and there is a contradiction because there is a need of money. Then, they decided to create an administrative sector which forces them to review the organization of the company, which have a cost. There is a kind of contradiction because Air Tex tries to implement a new control system which is very costly, where as the firm is on the verge of bankruptcy. They decided to gamble by implementing a new control system of course expensive, but with a long term return on investment. It's a bet on the future, very risky but necessary to right the helm.

### Recommendations

First, we think that Ted and Frank need to improve their knowledge about the plane sector. Then, we hire as soon as possible in each department an accountant to create a Department Daily Report and accentuate the autonomy of each division.

Furthermore, a training and development program will be interesting to improve the management skills of the staff. In fact, we believe that division managers are not correctly trained to take vital decision in a first time.

In the future, an incentive program more accurate can be developed to motivate and attract staff. It will be easy to implement it with the policy which consists in decentralizing the decision process.



The control process gives performance results of divisions each month. It's why, after months, Ted and Richards will analyze it and focus on few activities to avoid the scattering of the strengths. An effort must be made to strengthen the links with stakeholders, in the goal to be in position to negotiate with them.