

# Hcc industries

[Business](#), [Industries](#)



1. Evaluate the decision to use “ minimum performance standard” (MPS) targets instead of “ stretch” targets. The purpose of setting a budget system is to briefly forecast a company’s performance in the following year, and it can also be a result control system that makes people in the corporation work properly to achieve the objectives and give them incentives by bonus related to performance. From this point of view, the budget system should be reasonable, achievable, and also have some challenge to ensure the hard working. HCC Industries was using “ stretch” performance targets until 1987. The main idea of using “ stretch” targets was to motivate managers to perform at the highest level possible by setting aggressive targets with probability of achievement between 75 % and 80 %. In order to motivate the managers, incentive system was directly related to the budget targets. The bonus potential for division managers was 30% of base salary and was equally based on profit before taxes (PBT) and subjective rating of performance depending on the degree of accomplishment of the targets in all seven performance areas.

In case that only few of performance areas were not met, but the management considered them important, no subjective bonus would be provided. Objective bonus based on profit before taxes was provided as following: if 60 % of the budget was achieved, 80 % of the bonus potential was paid; if 100 % of the budget was achieved, 100 % of the bonus potential was paid; and if 140% of the budget was achieved, 150 % of the bonus potential was paid. Bonuses were paid quarterly at the level of 80 % of what was earned in order to prevent paying the bonuses that were not earned.

However, philosophy of using “ stretch” performance targets in HCC Industries did not work very well, since it encouraged thinking optimistically that pushed employees to perform at a higher level leading to innovation. This philosophy is advantageous for particular companies with a certain size that have an understanding of the markets and have an ability to influence them. HCC Industries was a small publicly held corporation which was just taking orders and not doing marketing. For this reason, there was little probability for the employees to enlarge the market and achieve an aggressive growth in sales every year.

Performance targets were set too high and optimistic, they were unrealistic, unachievable, and not suitable for a company which could not make a sustaining growth by influencing the market. One of the main disadvantages of “ stretch” targets was that they were set too high. This led to the situation that for the last four years HCC Industries never achieved its targets. As a result, employees lost their motivation and commitment to achieve the targets; they were discouraged, and exert less effort by giving up trying, as they felt that “ stretch” concept was causing the corporation not to achieve its plans.

If a division keeps missing the budgets, employees feel like a failure. Taking into account that the employees could not achieve the targets for already four years, they had lost their confidence and became used to missing the budget and the enthusiasm to strive for the objectives was weakened. Although the targets were set at an unreachable level, the control system was not that tight. Even if the managers failed to achieve the targets, they may also be paid the bonus. For example, the managers were still paid 80%

of objective bonus potential based on profit before taxes if they had just achieved 60% of the budget.

So if a manager was not so ambitious, he did not have to worry about meeting the budget. Moreover, important constraint to motivation of division personnel was that they did not know their bonus potential and the bases on which the bonus awards were made, as division managers did not want to disclose division-level financial information to their personnel. As a result, being unaware of the main objectives of the corporation and its incentive system, employees did not exactly know what they are expected to do and how they would be rewarded for their efforts.

As a result of the lack of communication between division managers, middle managers and employees, division personnel became discouraged and demotivated. In addition, if employees are systematically undercompensated, the corporation may suffer from losing key employees. Another disadvantage of “stretch” performance targets was subjectivity of incentive system. According to the information, provided from the case study, bonuses were paid only to employees included in the bonus plan. It can be concluded that not all employees were included in this plan.

Moreover, half of the bonus potential was based on subjective evaluation of top management. However, there is a concern whether top management could judge each division in appropriate way, taking into account all the differences between them. The aforementioned subjective aspect influences performance and motivation of employees. In addition, important demotivating factor was that awards had to be paid quarterly at the level of 80% of what was earned. It took three to four months before they actually

were paid because the necessary approvals by several levels were needed before the payments could be made.

The remaining 20 % was paid at the end of the year based on annual performance. Taking into account aforementioned challenges of using “stretch” performance targets, the management of the corporation had taken a decision to change the philosophy to “minimum performance standard” (MPS) targets from the fiscal year 1988 onwards. The philosophy provided a two-level budget standards. The first level included the minimum performance standard that determined the basic financial target that divisions should reach. The second level included the targets that were set more challenging, and had some incentive effect.

The main objective of this decision was to submit budgets with realistic targets with an achievement probability of 100% in order that divisions could meet the targets. As a result, division managers and other employees would become motivated by being proud of themselves, having self-esteem and starting feeling like “winners”. Being motivated, division personnel would be encouraged to work hard, be entrepreneurial and increase the level of aspiration for the future. Moreover, they would be given an opportunity to earn extra rewards.

Another advantage of highly achievable budget targets is that they reduce the costs of needed interventions from corporate managers and the costs of optimistic revenue projections. Highly achievable budget targets also reduce the risk of game-playing. However, not all potential advantages of MPS targets were achieved in HCC Industries. Before implementing MPS targets, corporate managers did not analyze carefully all problems that the company

faced on the level of operations, marketing and finance. Corporate managers of HCC industries introduced the following changes in the corporation connected with the switch to MPS budgeting philosophy.

First of all, the probability of the achievement of the budgets had been changed. MPS budgets were to be set with the felt probability of achievement 100%. In addition, managers were asked to set targets that exceed normal capability and involve an increase by 25-30 % with the probability of achievement of 50 %. However, although the budgets were planned to be set realistic and achievable, in reality they were too high and some division managers were even more than before concerned whether it would be possible to achieve them.

In some divisions, such as Glasseal and Sealtron, corporate managers just increased the planned budgets without any analysis of the actual situation and discussion about business potential and risks with the division managers. As a result, division managers became even more demotivated because of too optimistic budgets. Moreover, by missing the new budgets, employees could be fired. The division manager of Hermetite was not provided by top managers with essential information about the corporation, its strategy, targets and the actual situation, and targets of his division before planning the budget.

Being just hired and having the lack of experience and knowledge, he set too optimistic targets that could never be achieved in reality. As a result, the new division manager experienced failure and frustration at the beginning of his working experience in HCC Industry that had led to undermining of his confidence and commitment. Secondly, the incentive system had also been

changed. According to new incentive compensation plan, bonus pool consisted of 20 % of the amount by which actual division PBT exceed MPS and 25 % of the amount by which it exceeded the target.

Bonuses were paid quarterly at a level of 90 % of that earned and the remaining 10 % at the end of the year depending on the performance. It can be concluded that the rewards became lower than with “ stretch” performance targets. The probability of losing the job in case the MPS targets would not be met, became greater. The disadvantage of subjective judgment concerning the bonuses was not eliminated under the new philosophy, as the division managers were given the discretion to decide which of their subordinates would share in the bonus pool and how the pool would be allocated among themselves and the others included.

The key factor to the success of the budget system lied in the accuracy of forecasting the market share, the booking rate, the potential growth of sales, and so on. If a manager had little knowledge about the market information and the competitors, it would be difficult to set the MPS. The effectiveness of the budget system would be weakened, and this was the one of the main problems HCC faced after introduction of the MPS system. Evaluating the decision of changing the corporation’s philosophy based on early results, allows concluding that the new concept was not implemented well, even given the fact that it was a good idea.

After the first quarter of fiscal year 1988, none of the divisions achieved all of its MPS and some of the divisions missed their minimum performance by large margins. 2. Should HCC managers have expected that the MPS target-setting philosophy would be equally effective in all four operating divisions

described? HCC Industries was organized into four operating divisions: Hermetic Seal, Glasseal, Sealtrol that were producing connectors of various types, and Hermetite that was producing custom-designed, micro-electronic packages. Each division was run by a general manager who was responsible for all business functions of a certain division.

In order to properly evaluate and monitor divisions' results on which the bonuses were based, controllers of each division reported to HCC's CFO. Corporate managers should have taken into account that the divisions differ from each other, and should have considered each division separately while using MPS target-setting philosophy as each division had some specific characteristics that were different from others. Although all the three connector divisions were similar in that they were profitable but growing slowly, there was a significant difference in the degree of standardization of their product lines.

For example, division Sealtrol was highly standardized and produced connectors with large economies of scale. On the contrast, Hermetic Seal was the least standardized division and operated primarily as a job shop that designed and produced small batches of custom connectors. Glasseal's product lines had the medium level of standardization. The fourth division Hermetite was completely different from the connector divisions. In comparison with the first three divisions, its market and competitors were well defined and its potential for growth was tremendous.

In addition, Hermetite faced huge price competition and significant production technology and control challenges. Moreover, the production processes were complex and its engineering and production organizations

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were instable. Given the fact that all four divisions were independent from each other, had different targets, accounting and information systems, product standards, served different customers, had different professional background of division managers, a detailed analysis should have been made whether MPS targets would be equally effective in all four divisions.

Mike Pelta, the manager of the first division Hermetic Seal was more motivated after the changes, as with “ stretch” performance targets, the probability of the achievement of the targets was 85-90%, whereas with MPS targets it has increased by 95-98%. The reason of such a high probability of achievement the targets was the fact that the division manager had set conservative targets. Mike Pelta was a cofounder of HCC, and was more familiar with the situation of the company. From the first quarter revenue result of 1988, we can find that only Hermetic Seals exceeded target in both bookings and profit before tax.

But on the other hand, there were some problems in product qualities such as returns and rework. The manager of the second division Glasseal was even more demotivated after the changes than under the “ stretch” performance targets. After the division manager had prepared the budget based on realistic forecast, the targets were increased by corporate managers. As a result, the probability of the achievement of the targets remained 90%, as it was before changes. However, with the “ stretch” targets the rewards were greater and could be earned even if the budget was missed.

It could be concluded that the change for MPS targets had not become better and more motivated for the second division. Historical performance of the <https://assignbuster.com/hcc-industries/>

third division Sealtron was not so good. Efficiency in sales per employee was 50 % below other connector divisions, and budget was missed so salaries were frozen. The division manager, Lou Palamara, was recruited in 1986. Lou Palamara had a background of an engineering manager, so he was not that familiar with the corporation and had less knowledge about budget and cost saving. The division manager was discouraged by new

MPS targets, as the targets he set had significantly been increased by corporate managers and the probability of its achievement according to division manager, was only 60-65%. As a result, if the budget would have increased by 18 % compared to the previous year, there would be still no bonus earned. Moreover, in case MPS standards would not be achieved the manager could be fired. At the same time, CFO of the corporation assessed the probability of the achievement of the targets by 90%. His idea was to stimulate sales as the Sealtron's efficiency was below other connector divisions.

It can be concluded that the opinion of top managers and division manager on the achievement of targets was significantly different (90 % versus 60-65 %). In this situation, in order to come to common solution, additional analysis should have been done of actual situation and current performance of the division. It should have been carefully analyzed the reason of poor performance of the third division. Before the fourth division Hermetite was acquired in August 1985, it had been operating at a loss for the price competition and the production problems.

The former general manager of Hermetite left a serious delinquency problem, which had worsen the reputation of the company, so booking could

not be guaranteed. The manager Alan Wong, being new in the corporation and lacking particular experience and knowledge, was not provided with additional training and explanation of the corporation's and division's main objectives. He thought the corporate managers would not accept a budget that projected a loss. As a result, he had set very aggressive and optimistic targets that were unrealistic and corporate managers decreased the targets.

However, the probability of achievement of the performance target at sales was 80 % and PBT target was only 5 %. The performance of the fourth division was very risky and uncertain. From the first quarter results of 1988, we can discover that the bookings and shipments were both below MPS. After analyzing MPS targets in all four divisions, it could be concluded that only the manager of the first division, that was the original HCC business, was motivated by the changes. The managers of the other three divisions were even more concerned than before the changes.

The main reason of such situation was that corporate managers thought that the targets were achievable, whereas division managers had the opinion that they are not achievable and unrealistic. It can be concluded that there was a lack of communication between corporate and division managers. Moreover, the evaluation standards were the same for every division without taking into account different situation and various targets of each division. Given the fact that there were only four independent divisions, individual approach and specific evaluation standards for each division should have been used. 3.

What, if anything, could have been done to improve the implementation of the new philosophy? From 1988 onwards, the philosophy in HCC Industries had been changed from “ stretch” targets to minimum performance

standard (MPS) targets. However, according to the results of the first quarter of 1988, none of the divisions had achieved all of its MPS. It can be concluded that there were some problems in implementing new philosophy. First of all, the targets of every division should be aligned with the long-term strategy of the corporation. Top managers should clearly set the company strategy and priorities and communicate them to all divisions.

Division managers should in turn have been communicated to the corporate managers opportunities, resource needs, constraints and risks. HCC Industries would achieve success if all divisions would work together towards common targets and objectives instead of being concentrated on personal goals of each division that could diverge from the strategy of corporation. According to the information provided in the case study, corporate managers were confident that the set objectives were achievable and realistic, division managers had the opposite opinion.

As a result, division managers were discouraged to perform from the beginning. In order to avoid demotivation and increase the probability of the achievement of the targets, the balance should be found between the desires of the top management and the possibilities of the divisions. In that case, they closely need to communicate with each other and come together to the common solution. This would lead to more realistic budgets, would build employees up and increase managers' commitment to achieve the targets.

Secondly, as long as at HCC all divisions were decentralized, the differences and unique characteristics of each division should be taken into account. As a result, different performance evaluation standards should be used for

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every division. It is impossible to compare Hermetic Seal which is the original HCC business with Glasseal and Sealtron that were acquired even if all of them produce connectors. Moreover, the degree of standardization of product lines within these divisions is completely different. The fourth division is completely different from the first three.

That is why individual approach should be used for every division. There are only four divisions, that is why it is realistic for corporate managers to evaluate and analyze each division separately. Whereas some divisions could achieve higher targets, for others lower targets are more realistic. When planning the budget, the actual situation and performance of each division should be analyzed instead of comparison with other divisions. Before increasing the targets of the second and third divisions a more detailed analysis was needed.

In addition, it would be helpful for corporate managers to discuss with the division managers the possible constraints of poor performance of their divisions and to evaluate whether additional actions are needed in order to improve performance. In order not to demotivate employees, it would be better to agree the targets and to find compromise rather than just to set them. Corporate managers should establish the dialogue with division managers and other personnel in order to gather an objective opinion about the real situation inside the company.

Such working atmosphere would encourage employees to be involved in the company more and would give them the feeling that corporate managers listen to them when changing strategic issues. Division managers would feel themselves important in the organization and would be more encouraged to

perform at the highest level possible and would feel more responsibility for the achievement of the targets. Thirdly, top management before changing the budgeting philosophy should have made a sound analysis of current performance on corporate level as it is a very important decision.

Implementing new standards for evaluating involves the research of effectiveness of operation potential growth, the personal characteristics, the financial constraints, resource limitations, opportunities and risks. Fourthly, personal controls could be used by training division managers. For instance, it was very important for the fourth division to provide the manager with some additional information about the corporation before planning the budget.

Taking into account the fact that Alan Wong was relatively new in the corporation, it is quite obvious that he lacks some experience and knowledge to plan an effective and realistic budget. It is also clear from the information provided in the case study, that he was unfamiliar with the strategy of the corporation and the expectations from the top managers from his division. Planning the budget is very important for the corporation. It requires deep understanding not only the goals and objectives of a particular division but also of the entire corporation.

As there was a lack of communication between the top management and the division managers, the new division manager had set unrealistic budget. Fifthly, there was not only a lack of communication between top management and division managers, but also between the division personnel. In order to increase the motivation amongst personnel, the division managers should clearly communicate the main objectives and set

the targets to their employees and provide them with the detailed information concerning the incentive system.

In this case, employees would understand what they are expected to do and how they would be rewarded for that. Sixthly, as the marketing information collection was an obvious obstacle for the accurate forecast of the future, it is important to set up a marketing team in the four divisions. The target of the team is to collect the market share data of each product in previous years, the reasons for the up-and-downs of the market share, find out what kind of improvement will the target consumers need in the future, the scale of potential customers, and so on.

With the detailed information of the market, it will be easier for the division to forecast the future sales and try to expand the existing market. Seventhly, it can be suggested, that for the first year when the changes were applied, the top management could set very realistic conservative targets in order to encourage employees and make them feel that the targets are achievable. Given the fact that the targets were not achieved for the last four years the employees got used to missing targets and became demotivated.

In addition, given the fact that some divisions, for example Hermetite, experience current problems, flexible targets could be set, that would depend on certain conditions at a particular time. Finally, before taking a new decision about the changes, it could be helpful to organize the meeting with all division managers in order to announce them personally about the expected changes and gather some ideas from them about how to implement the new philosophy. Such brainstorming could help to pay

attention to some important aspects from the bottom that top management was not considering.