

Case hcc industries

Business



08 Fall 08 Fall 1. Evaluate the decision to use “ minimum performance standard ” (MPS) targets instead of “ stretch” targets. We evaluate the decision to use “ minimum performance standard” targets by looking at how good this new target system achieves the four purposes of planning and budgeting processes. First of all, planning and budgeting processes have to enhance management control.

Derived from the case, we think corporate managers have too much control on the targets. General managers give corporate managers an estimate of the targets they can achieve but in all the divisions, targets were adjusted.

The CEO always has the last call on the targets and in the case of Sealtron we see that this isn't good. No one believes Sealtron can achieve a PBT of 1million \$ and still the CEO wants that target. For the general manager of Sealtron this was very discouraging.

So indeed, management control on targets has increased but maybe too much. On the other hand, division managers now have more control on the bonus pool, they can decide which subordinates share in the bonus pool. That isn't good either because of the grade of subjectivity.

If you're not in good graces with the general manager, you will not achieve any bonuses. Bonuses are not based on how good you actually work but on how good the general manager believes you work.

So maybe the control on targets has to be reduced a little bit and the control on the bonus pool has to be made more objective. Secondly, the planning and budgeting processes have to engage in long(er)-term thinking. In the

system of “ stretch” targets, some divisions achieved their goals, some not but the company as a whole was consistently missing its targets.

In the MPS system they want to improve this. The problem however with the MPS system is that there is too much focus on operational planning, targets are set on short term.

Targets are the main focus of the company, even if you have to take measures that are disadvantageous towards the future. For example, in the Sealtron division the general manager hired some people that he thought would be useful for the company on the long term. But because the main focus lays on achieving the targets, Lou Palamara was afraid that he had to lay off some people that he will likely need in the future.

So the MPS system still supports rather the short term, there is no engagement in long-term thinking. Then the third purpose is to achieve coordination. The purpose of the company was to create a bottom-up approach.

In this approach division managers prepare the budgets and then forward them to the corporate managers for review and approval. Targets that are provided by the division managers tend to be more accurate and have a positive impact on employee morale because they know they can achieve the targets. They also get the feeling of autonomy. In the HCC case however, the implementation of the bottom-up approach goes wrong.

Division managers prepare the budgets and feel good about it but in each division the corporate managers adjust the budgets dramatically.

The way in which the corporate managers change the budgets is perceived as dictatorial. No general manager feels confident with the new adjusted budgets. And as said before, even some corporate managers doubt whether the proposed budgets are feasible. So the dictatorial adjustments from the CEO are rather perceived as a top-down approach, in which budgets are prepared by corporate managers and imposed on the lower managers.

The last purpose of planning and budgeting processes is to establish “challenging-but-achievable” performance targets.

In the “stretch” targets system, targets are perceived as “not unreachable, just tough”. The intended probability of achievement was around 75 to 80%. This is just slight below the desired level (80-90%). In the MPS system, the probability of budget achievement was above the desired level (Hermetic Seal and Glasseal) but in the case of Sealtron the probability of achievement is only 60-65%.

So again, if we look at all the divisions together, the company is missing the last purpose of planning and budgeting processes.

2. Should HCC managers have expected that the MPS target-setting philosophy would be equally effective in all four operating divisions described? No, they should not think so. The new MPS budget system has both advantages and disadvantages, which do not have effect on every division to the same extent and thus result in the difference of the effectiveness of the MPS target-setting philosophy on different divisions.

We will answer this question with the comparison of the 4 divisions’ reaction to the MPS system by looking over the characteristics of their managers, <https://assignbuster.com/case-hcc-industries/>

staffs, markets and other relevant aspects. We believe that Hermetic Seal is relatively suitable for the MPS philosophy. As mentioned in the text, Hermetic Seal's customers were mostly military customers, indicating that their contacts and sales did not change significantly according to the economic fluctuations and were more or less stable.

So Hermetic Seal was more likely to make a correct expectation about their future and make an achievable, as well as challenging, budget, which is the key of the MPS. Mike, the manager of Hermetic Seal, who was looking for a large bonus, would make more conservative budgets to ensure that he could always meet the targets. He intentionally lowered the budget target that he used to make, in order to let off the pressure to meet the targets, so at the same time he reduced the motivation to fight for more challenging targets as well.

Glasseal manager Carl feels more pressure about the budget and is thus more motivated to strive for the budget and keep his job. The budget target is challenging but achievable, as Carl is 90% sure to achieve the target.

This is a proper probability according to practical experience in the budgeting system. We believe that Glasseal is the best-suited division for the MPS system. Lou, the Sealtron manager, would like to pay more attention to long-term development instead of currently cutting costs.

He was upset with the MPS system but was forced to accept the system and the budget, so perhaps he is poorly motivated to implement the system. However, despite the manager's resistance to the MPS system, the performance of the division has improved under the new system and

achieved most budgeting targets that were considered as impossible when making the budget and even exceeded some of them.

The staff of the division used to be slothful under the stretch system when they didn't have to achieve the budget, whereas MPS is stimulating the staff to be more efficient.

In contrast to the three connection divisions reacting in a positive way to MPS, we consider MPS as a disaster for Hermetite. The division was keeping a horrible financial record in its growing period and needed to focus more on long-term development, so it was unfair and improper to judge and evaluate Hermetite's performance with financial criteria and to ask them to achieve all the yearly budgeting targets and financial criteria. Moreover, Hermetite's market situation was hard to predict, as it was unstable and changed significantly from year to year, so it was unlikely to make a proper budget based on a correct prediction of the future. Even worse, the manager of Hermetite, an optimistic person, would like to set high standards in order to achieve high performance.

He was upset with the new MPS philosophy, which forced him to accept a cut budget. And different from the "stretch" budgeting, which encouraged employees to achieve as high targets as they could, the most important motivation for employees in the MPS system is to keep their jobs. For Hermetite, which owned a huge potential and infinite future growth, the former system would have been better. To conclude, Glasseal suited the MPS philosophy best.

Hermetic Seal and Sealtron would also perform a relatively positive change in the MPS system.

But “ stretch” budgeting is better for Hermetite than MPS. 3. What, if anything, could have been done to improve the implementation of the new philosophy? In order to provide a schematic response to this question, we return to the structure used to provide an answer to question one, being the four purposes of planning and budgeting processes. The first purpose is to enhance management control. With regard to the implementation of the new system, the amount of management control exercised has altered quite ambiguously.

On the one hand, the creation of the bonus pool has augmented the amount of decentralized control to the division managers.

This was mainly a result of the critique that there was always substantial delay with regard to payments of the bonuses. However, in its current execution, this pool causes the problem of a lack of segregation of duties. A recommendation is thus to leave ultimate authorization of bonuses with the general management, as an attempt to create reasonable assurance of no fraud is being committed by division managers.

It would also cause division managers (who would still be able to appoint bonuses themselves) to account for the amount of subjectivity that is involved within this bonus system. The general management might ask explanations with regard to the division of bonuses.

On the other hand, the implementation has increased the management control to an unnecessary high level. As can be seen in the answer to the

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second question, the tensions between divisional and general management have raised substantially within someone divisions without resulting in a higher success rate of targets being met.

As a possible solution, an overseeing marketing function might be created. We envision two possible ways to exercise this measure. First, the function could be outsourced to a marketing agency, which would conduct an annual audit of the divisions and make suggestions regarding appropriate budget heights. In this way, the independence of this function can be assured.

Second, the function could be orientated internally as a staff function with a mandate in the board of directors. The benefit of this second option is a continuous review of the divisions (as opposed to periodical review through an external agency).

The main goal of creating this role is to provide general management with a better knowledge of the market circumstances in which the division operate. And if division managers feel that general managers can provide supported arguments for a certain level of target and/or budget, their commitment could be influenced positively, which is an important characteristic of a budget. The second purpose is to engage in long(er)-term thinking.

Using the current implantation, as we mentioned in question one, this purpose is completely missed. The organization does not achieve in completing the planning cycle.

The focus is mainly on operation planning, whereas strategic planning, programming and capital budgeting are taken insufficiently into the equation. When the company decided to change its philosophy, it envisioned <https://assignbuster.com/case-hcc-industries/>

a better coordination between divisional results so the company results as a whole would improve. But the results of this new philosophy don't account at all to this strategy. This lack of 'fit' between strategic and operational planning could be countered by the above-mentioned marketing function, but also by accepting a higher level of risk.

Especially with regard to Hermetite, HCC should be willing to accept the optimistic sales forecasts and even suffer losses during short term because in the long run it could perhaps achieve its immense growing potential and generate generous revenue and profit for the firm. In general, the general management should have thoroughly assessed the general mission, vision and strategy of the firm beforehand and used this more strictly as a guideline to the budgeting and target setting process. The third purpose is to achieve coordination.

The most important mistake committed by general management in this area, was the vigorous approach of the new top-down budgeting process. Although the general management tried to create a mixture of top-down and bottom-up in their system, their rather dictatorial approach has created the sentiment that the focus is purely on top-down budgeting. This approach could have been softened by a better communication towards division managers and other personnel.

This step might seem negligible, but it could seriously impact the culture that is present in certain divisions (for instance Sealtron).

Another possible measure is to decentralize some target-setting authority to division managers. Not total authority, but perhaps a system that involves

negotiating power over the extents of targets. It could involve limits to targets, instead of an absolute number. In this way, the coordination might evolve more towards a sideways coordination system. The last purpose is to establish “challenging but achievable” performance targets.

If the above-mentioned suggestions are addressed, we believe that this fourth purpose could be provided with reasonable assurance. It is an additional outcome to implementation of the recommendations already made.