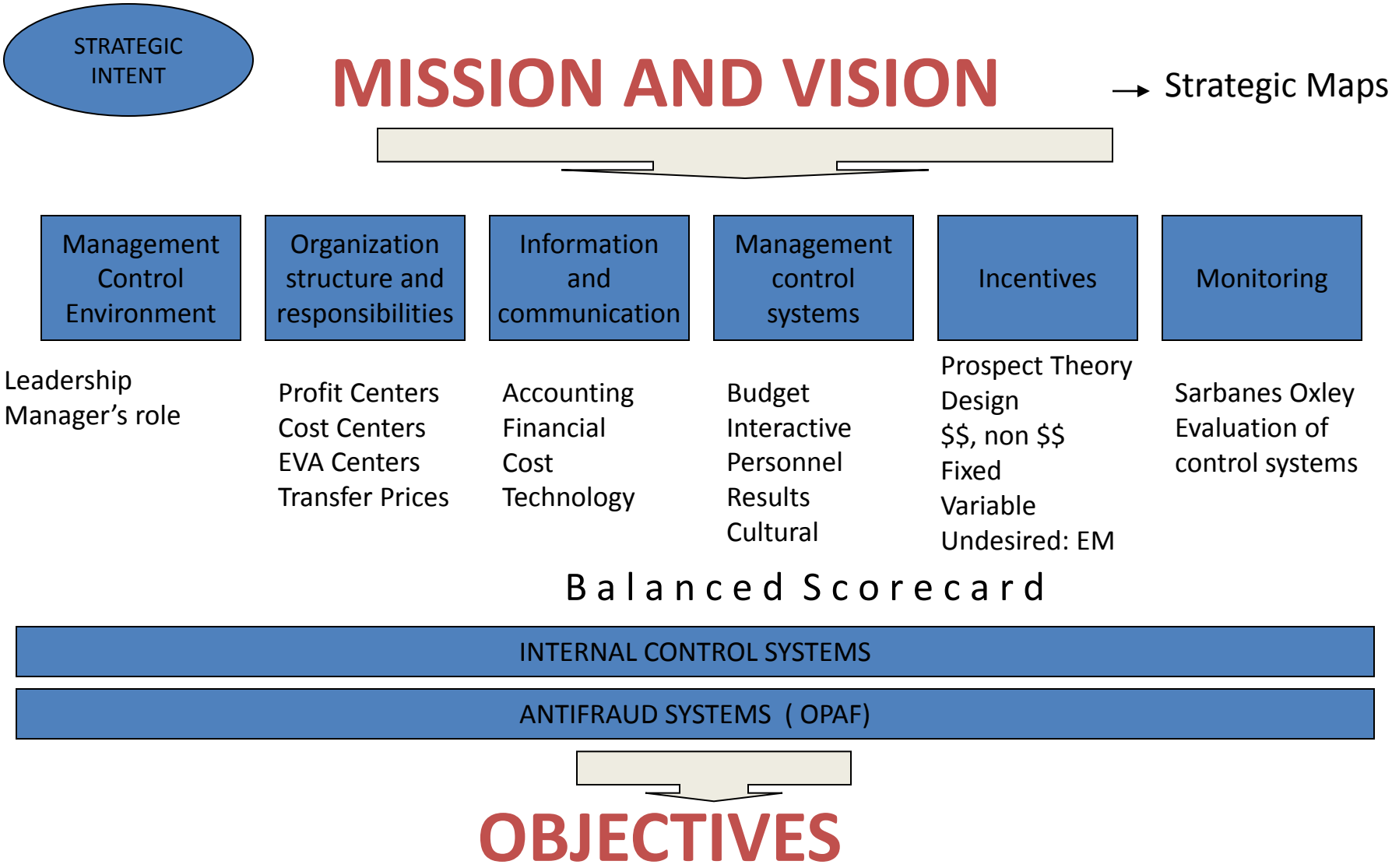
FALCON INC.

CASE GUIDE

2015

Management Control Process



Controllability Principle

A MANAGER IS NOT NORMALLY HELD ACCOUNTABLE FOR UNFAVORABLE OUTCOMES OR CREDITED WITH FAVORABLE ONES IF THEY ARE CLEARLY DUE TO CAUSES NOT UNDER HIS CONTROL

LUCK IS NOT A FACTOR IN RESULT CONTROLS AND PERFORMANCE EVALUATION

→ Uncontrollable factors hinder efforts to use result measures for control purposes

a. If possible, quantify the effect of recurring uncontrollable or set a band and adjust for the distorting effects of uncontrollable factors

   i. Before the actions: Insurance ii. After the action: Analysis of Variances

a. If it is hard to do so then result controls may not be appropriate

Examples of Uncontrollable Items

Uncontrollable items can be classified as those that are controlled by the parent company, the host country government, and other parties. The following is a list of examples of each type:

Items Controlled by the Parent Company

- Sales revenue and cost of goods sold determined by discretionary transfer pricing.
- Allocation of corporate expenses such as the chief executive officer's salary and research and development costs to individual operating units.
- Interest expense on financing obtained from the parent (or an affiliated finance subsidiary), which sets the interest rate.

Items Controlled by the Host Government

- Restrictions on foreign exchange spending that affect the supply of imported materials and parts.
- Controls on prices that may be charged for products and services.
- Local content laws that require component parts to be sourced locally, sometimes at noncompetitive prices.

Items Controlled by Others

- Lost production due to labor strikes.
- Lost production due to power outages.
- Losses resulting from war, riots, and terrorism.
- Foreign exchange losses.

EXHIBIT 13.16
Calculation of Return on Assets for Performance Evaluation

Source: Rosemary Schlank, *Evaluating the Performance of International Operations* (New York: Business International Corp., 1989), p. 31.

	Percentage of MNCs	
	U.S.	European
Items Deducted from Profit		
Depreciation	68%	57%
Share of HQ administration costs	60	36
Foreign exchange gains and losses	48	50
Taxes	46	71
Interest	42	57
Share of corporate R&D	38	64
Items Included in Assets		
External receivables	80	86
Intercompany receivables	33	57
Other current assets	75	79
Fixed assets	82	71
Goodwill	44	14

Falcon Inc.

Industry, structure, other

Japanese Subsidiary

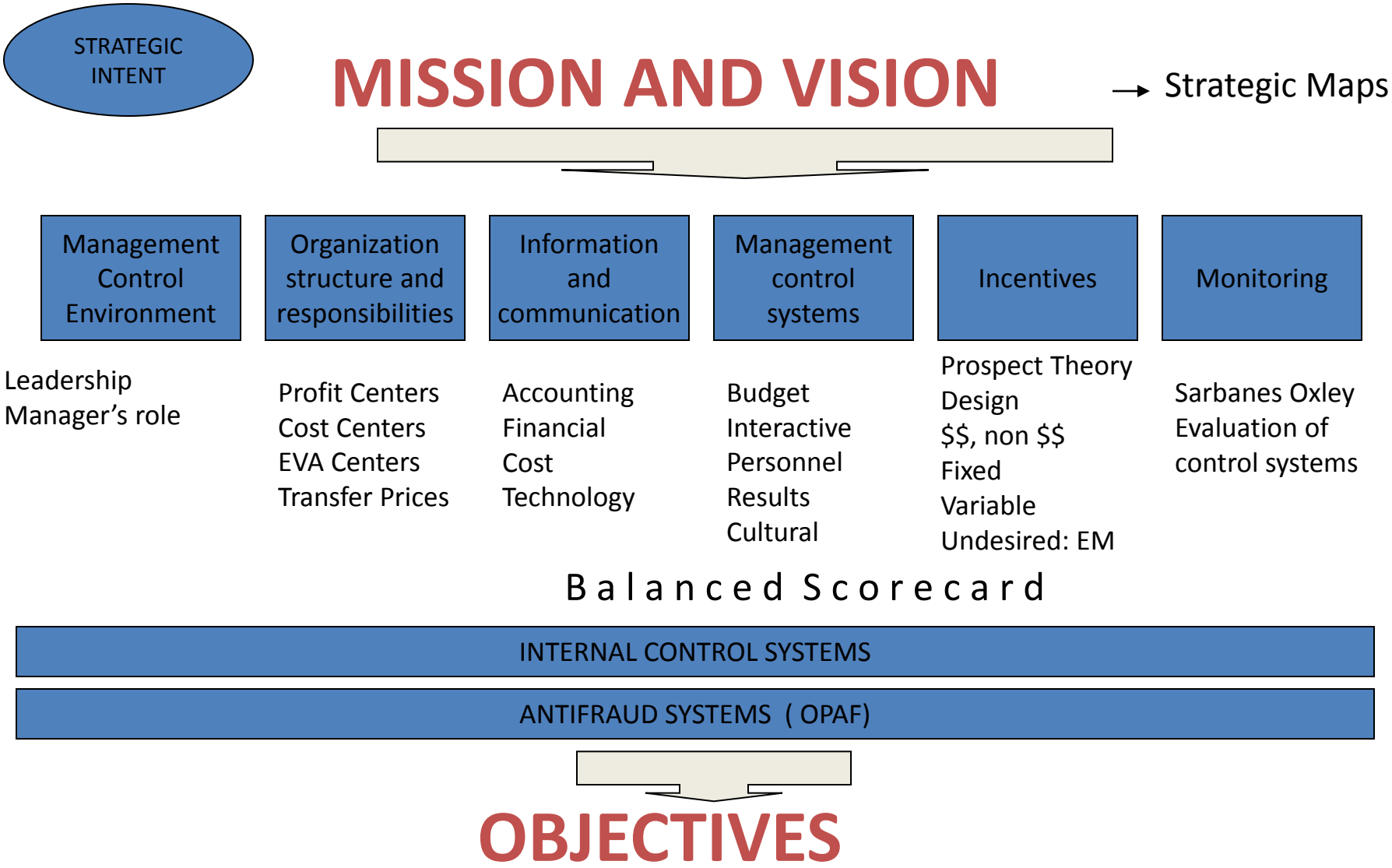
Danish Subsidiary

Interaction between HQ and Subsidiaries

Exports

Imports

Management Control Process



BUDGET				Denmark					Japan
	Units			50.000					250.000
	US$								
		Sales		41.400.000			Sales		102.000.000
		Costs		33.117.360			Costs		81.579.175
		Profits		8.282.640			Profits		20.420.825
	Local Cuurency								
		Sales		284.832.000			Sales		12.219.600.000
		Costs		227.847.437			Costs		9.773.185.165
		Profits		56.984.563			Profits		2.446.414.835
	investments								
		US$		20.706.600					510.520.625
		Local		142.461.408					61.160.370.875

<u>Set at beginning of the year exchange rate</u>

In tracking the budgets, Falcon uses the average-of-the-year exchange rates, since sales and costs typically occur uniformly over the year. The exchange rates were as follows:

Exchange Rates

	Denmark	Japan
Exchange Rate (LC per U.S.$1.00)		
2004 End	6.88	119.8
Average for 2005	6.47	111.8

Economies

Inflation: 2.25%

Exports

Imports

Inflation: 2.30%

Inflation: 4.30%

What can we conclude?

Real				Denmark					Japan
	Units			50.000					250.000
	US$								
		Sales		42.109.552			Sales		103.000.322
		Costs		32.417.764			Costs		85.161.145
		Profits		9.691.788			Profits		17.839.177
	Local Currency								
		Sales		272.448.801			Sales		11.515.435.972
		Costs		209.742.930			Costs		9.521.015.957
		Profits		62.705.871			Profits		1.994.420.015

What is happening in terms of performance evaluation of managers and subsidiaries?

TANAKA

BOGAGE

Is there something not optimal? What is the problem that the firm could be facing?

Peformance Evaluation

				DENMARK	IMPORTS IN US$, INCURRS IN REVENUES IN LC				
BUDGET				Real		Budget			Variance as Done
	Units			50,700	50.000				
	Local								
		Sales		272.448.801		284.832.000			(12.383.199)
		Costs		209.742.930		227.847.437			(18.104.507)
		Profits		62.705.871		56.984.563			5.721.308
	US$								
		Sales		42.109.552		41.400.000			709.552
		Costs		32.417.764		33.117.360			(699.596)
		Profits		9.691.788		8.282.640			1.409.148
									Very Good Manager

				JAPAN	EXPORTS IN US$, INCURRS COSTS IN LC				
BUDGET				Real		Budget			Variance as Done
	Units			249,000	250.000				
	Local								
		Sales		11.515.435.972		12.219.600.000			(704.164.028)
		Costs		9.521.015.957		9.773.185.165			(252.169.208)
		Profits		1.994.420.015		2.446.414.835			(451.994.820)
	US$								
		Sales		103.000.322		102.000.000			1.000.322
		Costs		85.161.145		81.579.175			3.581.970
		Profits		17.839.177		20.420.825			(2.581.648)
									Very Bad Tanaka

Exchange Rates Analysis		Denmark			Japan	
Annual Inflation Rate		4,30			2,25	
Beggining Rate						
	A	6,88			119,80	
	B	0,1453			0,008347	
Average Rate						
	A	6,47			111,80	
	B	0,15456			0,008945	
Expected Rate PPP		0,142562	7,01		0,008351	119,7
Nominal Exchange Rate Change		6,34%			7,16%	
Expected Exchange Rate During Year		-2,00%			0,05%	
Real Exchange Rate Change During Year		8,34%			7,11%	

What is the most important conclusion from this analysis?

Any proposals ???

Conclusions?

Managers?

Subsidiaries

Exports

Imports

What can a manager do to improve the process?

Jack Welch,
Former GE CEO

► **THE PEOPLE PART**

Now let's talk about the more controversial topic, differentiation among people. It's a process that requires managers to assess their employees and separate them into three categories in terms of performance: top 20 percent, middle 70, and bottom 10. Then – and this is key – it requires managers to *act* on that distinction. I emphasize the word "act" because all managers naturally differentiate – in their heads. But very few make it real.

When people differentiation is real, the top 20 percent of employees are showered with bonuses, stock options, praise, love, training, and a variety of rewards to their pocketbooks and souls. There can be no mistaking the "stars" at a company that differentiates. They are the best and are treated that way.

The middle 70 percent are managed differently. This group of people is enormously valuable to any company; you simply cannot function without their skills, energy, and commitment. After all, they are the majority of your employees. And that's the major challenge, and risk, in 20-70-10 -- keeping the "middle 70" engaged and motivated.

That's why so much of managing the middle 70 is about training, positive feedback, and thoughtful goal setting. If individuals in this group have particular promise, they should be moved around between businesses and functions to increase their experience and knowledge and to test their leadership skills.

To be clear, managing the middle 70 is not about keeping people out of the bottom 10. It is not about "saving" poor performers. That would be a bad investment decision. Rather, differentiation is about managers looking at the middle 70, identifying people with potential to move up, and cultivating them. But *everyone* in the middle 70 needs to be motivated, and made to feel as if they truly belong. You do not want to lose the vast majority of your middle 70 -- you want to improve them.

As for the bottom 10 percent in differentiation, there is no sugarcoating this -- they have to go. That's more easily said than done, of course. It's awful to "fire" people – I even hate that word. But if you have a candid organization with clear performance expectations and a performance evaluation process – a big IF, obviously, but that should be everyone's goal – then people in the bottom 10 percent generally know who they are. When you tell them, they usually leave before you ask them to. No one wants to be in an organization where they aren't wanted. One of the best things about differentiation is that people in the bottom 10 percent of organizations very often go on to successful careers at companies and in pursuits where they truly belong and where they can excel.