A new vision of management control based on profit centers and the impact on SMEs performance

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Abstract: - In an environment where ordinary standard product gives way to what some call "product-service", cost analysis requires more refinement, focusing on service and quality characteristics associated to products. The concept of activity came to the fore in recent years. Controlling costs and performance must be achieved through performance acknowledgment by people who are capable of making important decisions. In addition, management accounting seems to be ideal for remote "pilotage".

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1 Introduction

The complexity of economic activities, in conditions of competition imposed by the market economy leads to the increase in the role of economic and financial information in decision-making process. The quality of information depends on the quality of current decisions, decisions made on long term and the results expected by the company.

The decision making procedure is done through several steps:

- the identification of the problem to be solved;
- the identification of alternative directions of action;
- the analysis of the effects of each alternative on economic operations;
- the selection of the best alternative on economic operations;
- the selection of the best alternative as the current decision;
- the post audit review of decisions (feedback).

Each stage requires economic and financial information which is provided mostly by management accounting.

Cost and profit objectives are not only an acknowledgment of product cost but also an economic management of the business resources. Managing resources and costs is not only about trying to reduce them, but to achieve the best balance between expenditure and the utility it creates. This means making good decisions in all areas that influence the resources and business costs.

In an environment where ordinary standard product gives way to what some call "product-service", cost analysis requires more refinement, focusing on service and quality characteristics associated to products. The concept of activity came to the fore in recent years. Scientists agreed on the idea that the business costs must be mastered in order to operate on the cost of goods and services manufactured and sold by the company.

This rule determines the ability to influence people's behavior.

Therefore, management accounting cannot escape from its own ambivalence that makes it be considered at the same time a rational analysis technique used by managers and another technique which allows different influential persons to know the cost of their actions leading them to change their behavior.

Controlling costs and performance must be achieved through mastering staff's performances whom can be delegated o part of important decisions. In addition, management accounting seems to be ideal for remote "pilotage".

Clearly, costing products and services is no longer from now on, but an objective among others

management accounting and more and more directed towards the assessment of responsibility centers, which became basic units of computer system.

Information concerning production costs is used in evaluation of goods and profit measurement and represents the result of collecting data for management accounting system. It is well known the fact that the basis for decision-making costs is not accounting or average costs, but economic costs, unidentified by the system of accounts, which led the economic theory to make the distinction between accounting costs and economic costs.

Management decision should be based on relevant costs (costs which allow taking the best action for the management of the company), recognized by their forecast characteristics that registers hidden or opportunity costs, social costs and external costs. As decisions target future activities, management asks for detailed information concerning future costs, some of them not being included in accounting data collection system.

Financial management has its own technique, which leads its autonomy of decision to be recognized. On the other hand, decisions made by other management departments attract consequences in financial terms, as they require financial resources and needs, require receipts and payments. Accordingly, financial management is under the influence of all management decisions and reacts to all the steps taken in the company, because these measures have consequences in financial terms. But this management must be adapted according to projects in order to ensure the compliance with the major financial constraints of the company.

2 Management control based on centers: advantage or disadvantage?

There are many framing types of financial management within the organization and express at the same time, historical features (basic skills of the founders and seniors) and the company's expectations. The framing success of financial management within the organizational structure of the company depends on compliance with three fundamental conditions:

- organizational structure should express recognition of self-sufficiency and of technical skills necessary to self-finance the company;
- organizational structure should behave private procedures or mechanisms for coordination, negotiation and arbitration between financial management and other functions, resource-consuming or resource-generating for the enterprise;
- the organizational structure must ensure that relationships with external financial partners (bankers, stock exchange operators, shareholders) must be maintained by officers whose competence, autonomy and hierarchical position to be adapted according to the situation from the company.

It is stated that financial management is a set of methods of analysis and tools that allow businesses and other organizations to ensure efficient framing in their financial environment whilst management based on profit centers provide theoretical and practical framework for increasing performance.

Taking into consideration the above mentioned aspects, the main objective of the research report which we are committed, is to *identify, develop and deepen the management implications on profit centers regarding performance*. This key goal is broken down into three subordinate objectives (or operational objectives) as follows:

- organizational structure based on management centers - to identify "the place" that is occupied by profit center within the organizational structure of an enterprise to its preliminary, theoretical and practical as a "tool" to increase performance;
- management based on profit centers. Implications for economic performance – starting from identifying the need and opportunity management based on profit centers we have attempted to highlight the implications for economic performance;
- strategic management of profit centers "promoter" to "empty businesses".

The obvious trend dictated by the practice of the last decades of business management is customer-oriented and change-oriented which implies seeking the methods of management to ensure a business in terms of profitability and competitiveness, operating organization that allows easy use of modern management methods and techniques of leadership and organization.

Therefore, to meet customer needs and achieve a profitable activity, it is necessary **to structure the business activity on management centers.**

If in developed countries business management centers is widespread, in Romania there is still a resistance to this way of structuring the enterprise's activity, mainly due to the mentality of business leaders. It is therefore necessary to mention some ideas that support the organization business in this process:

- provides identification of responsibilities for expenses;
- expenses can be tracked and documented on places where they have been formed;
- determination of expenses in: expenses related to production activities and expenses not related to production activities;
- after establishing expected levels of expenses, the deviations from preset levels can be identified;
- set up a system of rules to identify the responsibilities of each performer;
- implement a system of resource allocation and tracking their use based on expenditure budgets for each center.

3 Profit Center: a vision on center management or a real advantage?

To identify the conceptual context in which it developed the concept of "profit center" as a form of group centers, we propose four approaches:

In his book **La gestion budgétaire, J. Margerin** shows that management centers can be considered as centers of decision, led by a responsible , because in this context, management is not an exclusive activity of the company's general management. Management centers can be found at all levels of the hierarchical pyramid of the company, having a certain degree of decentralization and delegation of decision- making. Before dividing the enterprise on centers of management, the leadership level will determine the delegation that wants to achieve, being very important at this point the future establishment of the company's organizational structure. The division of the enterprise's activity in management centers should consider the following requirements:

- management division of the centers should be based on existing organization within the enterprise and be updated only when the division of responsibilities should be amended;
- the management centers must include all the sectors of the enterprise, without any overlap of activities in more management centers;
- a management center can only be led by an appointed person;

Sharing problems in management centers do not appear in small enterprises where their owners largely exercise power. In this case the enterprise is one center of management whose performance will be analyzed through the income and profitability.

In large and medium enterprises, business is structured on management centers organized on several hierarchical levels of the enterprise so that the general budget will be divided into lower budgets according to each management center. A management center is a division of the company which has the following characteristics:

- it is placed under the authority of a manager;
- carries out one or more missions about quantitative targets and values;
- it has a set of resources to achieve the objectives;
- has relative autonomy in budget resources.

Making budgetary control involves:

- establish and review objectives;
- forecast consumption necessary to achieve objectives;
- control center on management effectiveness and efficiency.

J. Margerin divided management centers into the following categories:

- cost centers;
- discretionary expense centers;
- turnover centers;
- profit centers;
- profitability centers.

Cost centers (standard) are specific to departments or production workshops. In such a center, efficiency and effectiveness are expressed with the help of measurable indicators.

Discretionary expense centers are those expenses that can not be settled on a plan of production activity. These centers are characterized by the fact that the result of their activity is not measurable. In these centers it is difficult to tell the difference between structure costs and variable costs, so all the costs of the center will be treated as structure costs.

These centers are called "costs centers targeting" because of their budget is established based on the manager's experience of these centers; their objective is to exercise good quality services in terms of their enrollment in a budget. It should be noted that the activity of these centers can't be measured directly. The budget of costs centers targeting is a budget of authorized expenditure or in other words, is a budget of business administration.

The costs of these centers are "available" for their managers. The way of supervising the use of these budgets is to limit the maximum number of management centers within the functional services and oversight the trend of increased costs of these centers. It should be noted that the effectiveness and efficiency indicators are not measurable in these centers.

Turnover centers (centers of products or revenue centers) target to achieve a sales volume of production pre-set in order to maximize the turnover. This is the case of a sales department whose manager has no authority over the price level, but must comply with the tariff set by the general management of the enterprise. Also, the managers of these centers have no control over distribution costs, they must fit within the allocated budget to increase sales as much as possible.

Profit centers are centers whose managers have to find the best match between costs and receipts. This example can be found in a production line or in a store with finished goods, that sells at a pre-production cost (standard cost) and which is responsible for profits resulting from activity center, so that profit obtained is measured in terms of "margin" and is defined as the difference between turnover on the one hand, and the amount of production costs of the products sold and the costs of selling (distribution), on the other hand.

The objective of a profit center can be expressed in absolute values and in percentage depending on turnover.

The overall budget of a profit center can be classified into:

- products budget;
- expenditures budget;
- profit or margin budget.

Centers of profitability (investment centers) are centers whose responsibility is focused on assets employed. These centers represent a version of profit centers, whose manager has not only a profitability target based on sales, but also based on capital employed. In fact, two different levels of profitability centers can be considered:

- the level which actively participates in choosing the investment type and whose objective is expressed as a ratio:

The result of the center (or margin) / gross immobilizations + working capital needs of the center

- the departments which are responsible for managing current assets, whose objective is expressed as:

Margin center / Working capital needs of the center

M. Gervais stated in his book entitled **Le contrôle et la gestion budgétaire de l'entreprise**, that the enterprises have to adapt to the environment and also to the strategy developed, in order to evolve the organizational structure.

Management based on profit centers is the most important and efficient solution to improve the economic performance of enterprises.

Its promotion and use is not only necessary but also appropriate for the following reasons:

- generates a new attitude to the factors that determine the strategic decision-making, economic and financial, human, value-generating;
- causes a fundamental change in organizational culture;
- generates a new attitude towards objectives, they become the benchmark for performance;
- allows detection of "centers vicious" and highlighting the rapid "virtuous centers";
- promotes a severe state of rigor by identifying objectives and ways of achieving them, and by outlining procedural elements within each organizational structural components (positions, functions, departments);
- provides financial discipline at each hierarchical level of the company, on the one hand by promoting interconditioned objectives in a system of objective and secondly by ensuring appropriate correlations between expenses and revenues;
- is a trigger for complex actions to maximize global income.

The management use of profit centers has implications for economic performance at the enterprise level and subdivisions levels as well. This complex and sophisticated "instrument" provides remarkable results in terms of objectives.

According to authors Ion Verboncu and Michael Zalman the most important key performance indicators are:

❄ **Cost of production: per unit and total (product, work or service)**

If considered overall, the cost does not change at the product / work / service level, but requires new dimensions given by the following system: cost-hour-production (CHPS). This involves the use of background and determining mechanisms totally different from those of order method or other traditional methods of calculation. The calculation of unit costs provides a realistic determination of unit profit, and hence the profitability of each product / work / service.

Benefits would enhance the production by taking into consideration profitable products based on information on costs and profits per unit, decisions able to improve the assortment structure. It also may increase the renewal rank of production achieved, the profitability of the company can be improved, and management centers can become more efficient.

❄ **Labor productivity**

The goal of profit centers, and thus the management of an enterprise is to provide a realistic sizing of the necessary positions, depending on the objectives, the complexity and volume of work required to achieve them. Rigorous determination requires sizing the necessary staff in order to satisfy the requirements of efficiency and effectiveness of posts.

Benefits resulted would be increased productivity and the turnover.

❄ **Dimensioning the results**

Establishment and functioning of profit centers allow the identification, determination and tracking the profitability of each profit center. Comparing the assumed objectives with the results obtained at the profit center, allows the identification of other indicators of economic performance: costs, rates of profitability, productivity, turnover, etc.

❄ **Managerial performance benefits**

Increased performance is the result of how they are harmonized with increased decentralization of economic and managerial decision-making and operational autonomy.

❄ **Cost of operating hours (COH)**

This performance indicator provides an active competitive spirit between profit centers. However, the cost of operating hours is an important parameter for determining the costs and highlight deviations from the normal costs.

4 Conclusions

Studying the implications of management issues based on profit centers primarily leads us to pay attention to the management of resources, because the optimization can be achieved only through careful decentralization and delegation of authority.

Good information management at the enterprise level enables management to determine the performance of profit centers, comparative analysis of revenues, expenditures and results and to ensure level compliance of predetermined costs. Good management creates value added profit centers. Management value added means more than indicators measuring value. It requires management processes, operational efficiency, reward management resources, coherent management. Value creation is the result of a complex task to manage all aspects of business. Value indicators go beyond accounting results because they are related to cash flow forecasts. Accounting results follow to investment decisions, operational and financing and are guided by cash flows. There is not only an indicator of value creation that should be the ideal choice for every company.

Implementing a value-based management system requires changes in business culture. Managers should involve in directing their efforts towards meeting the interests of shareholders of the company. For this purpose, managers must recognize the need and opportunity for education and training of employees in the undertaking, especially those who are in key positions. For a successful strategy in the future, managers must identify value creation centers, to give them their full support, to focus on providing resources to be used effectively; at the same time there must be implemented the best projects that create added value.

Many consulting companies, financial services and many probationary employees in the economy, have developed their own theories regarding value-based management. Measuring performance indicators are evolving to improve previous models.

The company must take into account that it will reach a time when efforts shall not provide the expected results and indicators for measuring the value will show that instead of high value rates, there will be lower rates.

The solution proposed by the article is to implement a redesigned business management at the level of profit center and management centers, in order to generate competitive advantages in the market. Applying this concept theoretically creates the following practical advantages:

- "applied" development of the term forecast;
- implementation of realistic policies and strategies focused on market research, diagnostic studies, prospective studies, studies of indicators;
- flexible organizational structures, becoming more efficient and dynamic determine the "aggressive" behavior of the company towards the national and international business environment;
- modernization of financial "assessments", providing structural and functional change of decision "elements" to deal with endogenous and exogenous evolutions of enterprises;
- increased dynamism printing company activities and results, which eases superior economic performance;
- allows the implementation of an organizational architecture of holonic type, favoring the division of enterprise in modules with a prevailing operational autonomy.

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