271: Incentives and Controls

Instructor
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Office hours:

Required Readings
Selected chapters from Brickley, Smith and Zimmerman (BSZ), Managerial Economics and Organizational Architecture and from Lanen, Anderson and Maher (LAM), Fundamentals of Cost Accounting.

Recommended Readings
Young and O’ Byrne, EVA and Value-based Management.

Kaplan and Norton, The Balanced Scorecard.


Hilton, Maher and Selto, Cost Management.

The entire book, Brickley, Smith and Zimmerman, Managerial Economics and Organizational Architecture.

Course objective
To understand how organizations use financial and non-financial performance measurement and incentive systems to motivate people and manage resources.

Issues discussed
Fundamental questions that we address:
What behavior do the organization’s managers want to motivate?
What behavior does the organization’s incentive and control system actually motivate?

Topics include conventional issues in performance measures and rewards and more recent innovations. We discuss traditional topics such as the use of return on investment and transfer pricing because they continue to pervade business organizations and likely will for many years. We also discuss newer topics such as the balanced scorecard, economic value added and relative performance evaluation. Finally, we discuss incentives to commit fraud and regulations of controls such as the Foreign Corrupt Practices Act and the Sarbanes–Oxley Act. Critical elements of this discussion include business strategy, culture and responsible business practices.

Grading
• (20%) Participation in class discussion.
• (15%) Written assignments.
• (40%) Examination (take home).
• (25%) Course project on incentives and controls. This project is due at the beginning of class, Session 11. May be done in groups of two or three students. This project should be either a critique of an existing incentive and control system or the development of a system for an organization. The project should include discussion of the appropriate organizational structure, performance measurement, and incentives (rewards and penalties).

Class Courtesy

This is a discussion class that requires your undivided attention. Please do not use laptops or cell phones in class because they are distracting to your colleagues. Failure to comply with this courtesy will result in a loss of all class participation credit for the class period.
Incentives and Controls: Weekly Schedule and Assignments

**Week 1 (April 3). Introduction to the course.**

Reading Assignment:
*BSZ* Ch. 11 (“Organizational Architecture”).

Topic:
Organizational architecture—basic issues in designing incentive and control methods.

Written Assignment (done in class):
Give one real world example each of organizations that use hierarchical (bureaucratic) controls, market controls and informal controls.

**Week 2 (April 10). Organizational Architecture and Decision Rights**

Reading Assignments:
1. *BSZ* Ch. 12 (“Decision Rights: The Level of Empowerment”)
2. *LAM* Ch. 12 (“Fundamentals of Management Control Systems”) and Ch. 15 (“Transfer Pricing”)

Topic:
Organizational architecture and application to Human Auto (handed out in class). The use of transfer pricing in each of the three approaches to controls.

Written Assignment (done in class):
Human Auto case write-up.

**Week 3 (April 17). Performance Measurement: Financial Performance**

Reading Assignment: *LAM* Ch. 14 (“Business Unit Performance Measurement”)

Written Assignment (to be done before class and brought to class):
Answer the questions at the end of the Diversified Electronics case (14-38 in *LAM*)

Topics:
Financial performance evaluation.
Relative Performance Evaluation (RPE).

**Week 4 (April 24).**
Written assignment: Bring the income statement, balance sheet and enough information to compute EVA for three years for one company to class.

Topics: Economic Value Added (EVA®).
Week 5 (May 1). Non-financial performance measures and the Balanced Scorecard.

Reading Assignment:
*LAM* Ch. 18 (“Nonfinancial and Multiple Measures of Performance”)

Written assignment:
Barrows, Inc. case (14-37 in *LAM*). To be done before class and brought to class.

Topics: Balanced Scorecard.

Week 6 (May 8). Incentive plans

Reading Assignments:
(1) *BSZ* Ch. 14 (“Attracting and Retaining Qualified Employees”)
(2) *BSZ* Ch. 15 (“Incentive Compensation”)

Topics:
Alternative incentive plans. Management compensation.

Week 7. (May 15). Guest speaker.

Guest speaker: Roger Valine, former CEO of VSP (Vision Services Plan)

Reading Assignment: Search the Web for background information on VSP. You do not have to turn in an assignment, just learn about VSP to prepare for the guest speaker’s talk.

Week 8. (May 22) Take home examination.

No class meeting. Good luck on your exam.

Weeks 9 and 10. (May 29 – June 5). Public policy and controls

Topics:
Divisional fraud. Sarbanes-Oxley Act (SOX), Foreign Corrupt Practices Act (FCPA) and internal controls.

Written assignment: To be announced. To be done in class.

Week 11.

Course project due at the beginning of normal class hours on June 12.