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CONTROLLING

Modern Techniques

Return on Investment Return on Investment (RoI) is a useful technique which provides the basic yardstick for measuring whether or not invested capital has been used effectively for generating reasonable amount of return. RoI can be used to measure overall performance of an organisation or of its individual departments or divisions. It can be calculated as under.

$$\text{RoI} = \frac{\text{Net Income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Total Investment}}$$

Net Income before or after tax may be used for making comparisons. Total investment includes both working as well as fixed capital invested in business. According to this technique, RoI can be increased either by increasing sales volume proportionately more than total investment or by reducing total investment without having any reductions in sales volume. RoI provides top management an effective means of control for measuring and comparing performance of different departments. It also permits departmental managers to find out the problem which affects RoI in an adverse manner.

Ratio Analysis

Ratio Analysis refers to analysis of financial statements through computation of ratios. The most commonly used ratios used by organizations can be classified into the following categories:

1. Liquidity Ratios: Liquidity ratios are calculated to determine short-term solvency of business. Analysis of current position of liquid funds determines the ability of the business to pay the amount due to its stakeholders.

2. Solvency Ratios: Ratios which are calculated to determine the long-term solvency of business are known as solvency ratios. Thus, these ratios determine the ability of a business to service its indebtedness.

3. Profitability Ratios: These ratios are calculated to analyse the profitability position of a business. Such ratios involve analysis of profits in relation to sales or funds or capital employed.

4. Turnover Ratios: Turnover ratios are calculated to determine the efficiency of operations based on effective utilisation of resources. Higher turnover means better utilisation of resources. The table given below gives examples of some ratios commonly used by managers.

Responsibility Accounting

Responsibility accounting is a system of accounting in which different sections, divisions and departments of an organisation are set up as 'Responsibility Centre's'. The head of the centre is responsible for achieving the target set for his center. Responsibility centers may be of the following types:

1. Cost Centre: A cost or expense center is a segment of an organisation in which managers are held responsible for the cost incurred in the Centre but not for the revenues. For example, in a manufacturing organisation, production department is classified as cost center.

2. Revenue Center: A revenue Centre is a segment of an organisation which is primarily responsible for generating revenue. For example, marketing department of an organisation may be classified as a revenue center.

3. Profit Center: A profit Centre is a segment of an organisation whose manager is responsible for both revenues and costs. For example, repair and maintenance department of an organisation may be treated as a profit center if it is allowed to bill other production departments for the services provided to them.

4. Investment Centre: An investment centre is responsible not only for profits but also for investments made in the centre in the form of assets. The investment made in each centre is separately ascertained and return on investment is used as a basis for judging the performance of the centre.