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Key Item Control

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Management by exception and various other techniques have been developed to help executives cope with the accelerating information load. Here's another approach—and an example of how it works—

KEY ITEM CONTROL

by Howard G. Johnson

Price Waterhouse & Co.

A TOP executive of a leading company looked at a pile of reports on his desk. He told an associate, "I take several reports home almost every night. Even so, I don't find time to read them all, let alone to study them. I just don't seem to have enough time."

This is not an unusual situation. The life of the typical top executive has become incredibly complex. The era of the professional manager has placed greater emphasis upon the use of objective control information and performance measures. In addition, the modern computer produces a great abundance of management data.

At one time a major problem of the top executive was obtaining management control information. Now the problems are often ones, first, of winnowing out the valuable data from the mass of less important information and, second, of interpreting, organizing, and absorbing the data so that it can lead to a meaningful program of action.

Unfortunately most reporting today is geared to the purposes of the middle manager or supervisor. The top executive receives either the same reports or a readily prepared summary of the information sent to middle management. Few reports are designed to satisfy spe-

cifically and expeditiously the informational needs of the top executive. Often those needs are not even recognized as differing in kind and quality from those of middle management.

Many executives consider these to be personal problems and set out to solve them as best they can. At one extreme, the executive solves them by flash reading or only glancing at most reports and telling his secretary to file them. At the other extreme, he solves them by grinding conscientiously through them all, thus increasing his working hours per day to intolerable proportions.

EXHIBIT I

TYPICAL KEY ITEMS OF INFORMATION

For Key Item Control Reporting System

MANUFACTURING *

- Material requirements and receipt schedule
- Material yield
- Inventory turnover
- Labor schedule
- Labor productivity
- Factory personnel turnover
- Facility load and equipment utilization
- Portion of orders shipped on time
- Planned product engineering changes
- Planned changes in production facilities
- Quality performance
- Unfilled supervisory and other positions

MARKETING

- Share of the market
- Expected growth of industry and market
- Extent of sales coverage
- New business and order backlog
- Sales performance and trends (by man, area, product)
- Competitive activity and features of competitive products
- Prices compared with competitors'
- Effect of price changes upon volume
- Customer complaints
- Promotional plans
- Market potential for new products
- Market potential of styling, materials, and other changes in existing products

FINANCE

- Return on investment and profit
- Profit effect of planned actions
- Breakeven points
- Departmental costs
- Capital expenditures
- Accounts receivable collection period
- Working capital
- Financing requirements
- Cost reduction and work simplification plans
- Investment analyses and plans
- Potential acquisitions
- EDP and other systems development plans

More often, however, top executives are wondering if these aren't companywide problems that should be attacked on a companywide scale. One technique that has been found useful in this area is called "key item control." In its simplest form it involves sharply focusing the reporting upon those key areas requiring top-level attention. In its more complex forms it moves from a reporting technique into a system for planning and managing the key control areas throughout the company. A brief outline of its principles and a case study of its use in a hypothetical company are offered in this article.

The ground rules for this system are, first, to plan and control those areas in which good or poor performance can materially influence the results of operations, and, second, to report that performance in the most easily understood and action-provoking manner. The key items requiring control might be of many types: financial data, such as return on investment and order backlog trends; quantitative statistics, such as labor productivity and personnel turnover percentages; and qualitative information, such as product styling and work simplification plans. The identification of key action indicators, not merely reference statistics, is vital to the success of the system. Establishing key item control for a company involves four basic steps.

Identify key items

The first step, identification of key items, is, of course, the foundation of the entire program. It requires time and effort to select areas that materially influence results of operations and continuing attention to ensure that revisions are made to meet the changing needs of management. Normally a top-level staff assistant or an outside consultant is required to help identify areas and coordinate and guide the development of the control system in an organized manner. Typical key items for a medium-size manufacturing company

are shown in Exhibit I on this page to illustrate the types of factors that might be identified for control by the system. Most of these items of information are available in the average company, but they are not subject to the proper degree of planning or singled out for top-level attention as under a key item control system.

The actual key items for a company have to be tailored to the company size and industry as well as to the specific objectives, background, and techniques of the top executives managing the company. Tailoring the selection to the executives is particularly important.

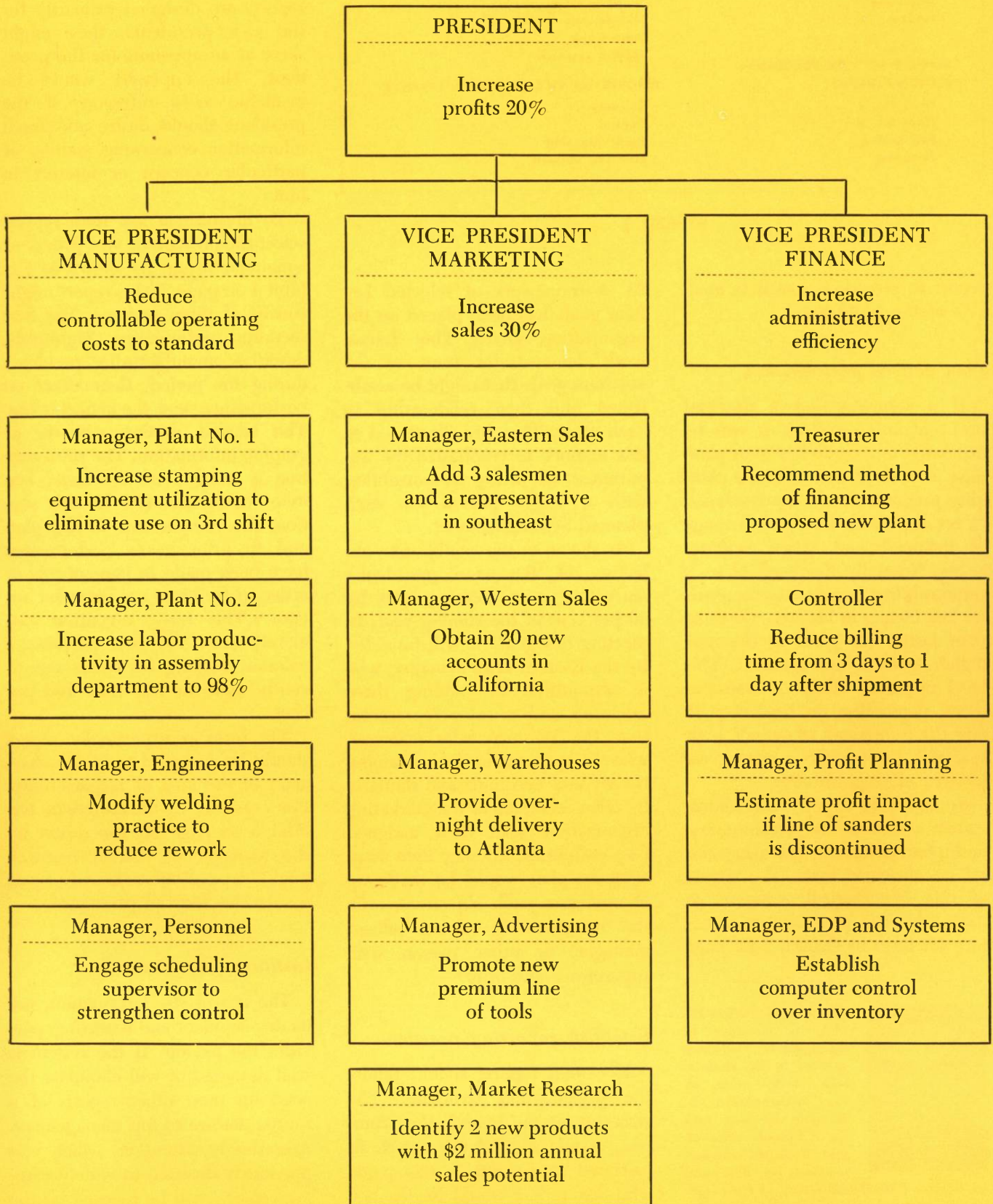
A good example of its importance is the case of a recent installation of a key item control system for a large company. The president had started with the company 40 years before and knew the business intimately. The executive vice president had been engaged within the last year or two. While he was an excellent administrator, most of his career had been in another industry.

Obviously, their needs were different. The president needed only limited information—but information that focused sharply on performance in several key activities of the business. When a problem arose, he usually knew intuitively the contributing causes and how to proceed. He wanted his key item report to alert him to problems and unfavorable trends, but not to go any further.

On the other hand the executive vice president desired more extensive information. If sales went down in a particular area, he wanted to know if sales calls had gone down, if customer complaints had gone up, if the dealer organization had changed, what the status of customer inventories was, if competitive activity had increased, what marketing and promotional strategy was being followed, if any major customers had been lost, if the sales loss was in high-profit or low-profit product lines, and other similar information. He depended on the key item

ELECTRICAL PRODUCTS COMPANY

Organization Structure and Selected Key Item Goals



ELECTRICAL PRODUCTS COMPANY

Kinds of Key Item Reports and to Whom Sent

<p>REPORT TO BOARD OF DIRECTORS REPORTS TO PRESIDENT</p> <p>Manufacturing Marketing Finance</p>	<p>REPORTS TO VICE PRESIDENT— MARKETING</p> <p>Eastern sales Western sales Warehouses Advertising Market research</p>
<p>REPORTS TO VICE PRESIDENT— MANUFACTURING</p> <p>Plant No. 1 Plant No. 2 Engineering Personnel</p>	<p>REPORTS TO VICE PRESIDENT—FINANCE</p> <p>Treasury Control Profit planning EDP and systems</p>

EXHIBIT 3

the president and departmental reports to the vice presidents. The president should have a good view of performance for the period from his reports. Although the remaining reports are designed primarily for the vice presidents, they might serve as an appendix for the president. The appendix would be available as a reference if the president should desire additional information concerning matters of particular concern or interest to him.

To illustrate a key item report, select the position of vice president—manufacturing. As shown in Exhibit 4 on page 25, his report might consist of three sections. The first section, performance highlights, describes manufacturing problems during the period, their effect on performance, and the action taken. The second section consists of graphic information. The third section is a table of additional key items of information. In this section, the comparisons to the plan and to prior year's performance have been made in percentages in order to facilitate management review. The busy executive can merely scan the two percentage columns looking for items significantly more or less than 100 per cent.

The form of a particular report should be designed to fit the character of the area of responsibility. For example, as illustrated in Exhibit 5 on page 26, the report by the manager of market research might depend more heavily upon a narrative form of presentation.

Institute control action

The use of the information, not its development and reporting, provides the pay-off. If the system is well designed, it will eliminate the need for most other reports of a routine nature to top management. Accordingly, attention, which was previously diverted to widely varying reports, will be focused on the relatively few "big-impact" problems. This, by itself, often has a

report to provide a complete analysis of the problem.

Plan desired performance

If a company has a financial profit planning system, it can be expanded to include key item planning as well. If not, a formal planning program should be developed to set objectives for the full range of financial and other performances. Normally the head of each responsibility is asked to set goals for key factors in his area. He must then justify his goals to the next higher level of management. This level approves them or restudies them, depending on how they fit into the framework of overall goals that this level itself is setting for its area of responsibility.

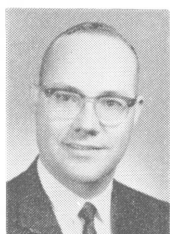
To illustrate a key item control system, assume a medium-size, multiplant firm manufacturing and selling electrical tools. The nature of this hypothetical company is shown by the organization structure set forth in Exhibit 2 on page

23. A framework of selected key item goals has been placed on the organization chart. This framework demonstrates some of the key item goals that might be established and their relationship to each other. They are illustrated in this manner to emphasize the importance of fixing responsibility with a single person for each planned accomplishment.

As shown in the exhibit, one objective of the vice president—marketing is to increase sales by 20 per cent in the coming year. In meeting this goal, he will be aided by the Eastern sales manager, who is responsible for adding three salesmen and a sales representative; the Western sales manager, who is responsible for obtaining twenty new accounts; and similarly by other members of the marketing organization with their assigned responsibilities. The key item management plan would be made up of numerous such objectives, each the responsibility of an officer, manager, or other person with supervisory authority.

Establish reporting practices

Key item reports should follow the organization structure. The structure of the hypothetical company would suggest the reports illustrated in Exhibit 3, this page. The first report would be the key item report to the board of directors. The remaining ones would be



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Johnson: Key Item Control
ELECTRICAL PRODUCTS COMPANY

Periodic Manufacturing Report

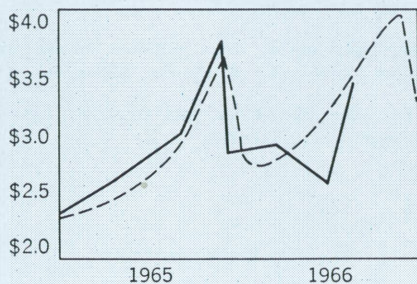
PERFORMANCE HIGHLIGHTS

Shipments increased as expected this month. However, Herron Manufacturing Co., one of our principal motor suppliers, was on strike until four weeks ago. Accordingly, we were not able to build inventory as planned in preparation for the added shipments. As a result, we had to go to a partial third shift for the assembly department and add a number of new employees

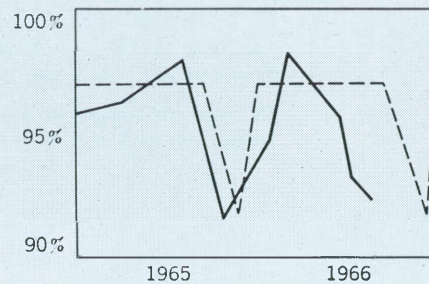
throughout the plants this month. The inexperience of the new employees and the lack of adequate supervision on the partial third shift led to decreased delivery performance and labor productivity, particularly in the machining department. These problems have been largely corrected and we expect improved performance next month.

KEY INFORMATION

Standard value of shipments (millions)



Percentage of orders shipped on time



----- Planned ——— Actual

	Actual as Percentage of		
	Actual	Plan	Last year
Year-to-Date Expenditures (millions)			
Operating—controllable	\$15.61	102%	122%
Operating—uncontrollable	\$ 5.95	101%	109%
Capital	\$ 1.10	104%	81%
% of Tools Passed Inspection			
Month	97.6%	98%	99%
To date	99.4%	99%	100%
% of Labor Productivity			
Month	91.5%	93%	94%
To date	98.1%	101%	103%
Inventory Turnover	3.9 times	98%	100%

EXHIBIT 4

Example of a Key Item Report to President

dramatic impact on problem solving activities.

The actual control techniques might vary. The senior executive favoring formal methods of stimulating subordinates might schedule regular monthly meetings. These meetings might even be held in special chart rooms allowing visual aids to be used in discussing performance and future plans. Other executives might favor less formal methods. They might review the reports as time permits each month and follow up with sub-

ordinates during the normal course of their association.

One president followed a middle-of-the-road practice. A scheduled plane trip early each month was used to provide time for studying the key item reports. During the trip he wrote his questions, ideas for corrective action, and notes for follow-up in the margin of the report. Upon his return the vice presidents could expect a call to discuss their reports. In addition, when the reports were designed, a special section was in-

cluded at the president's request. The section had space for four or five sentences of narrative comments. Nothing could be included in the section except as specifically prescribed by the president. When he was particularly concerned about the results of a critical course of action or progress in correcting a troublesome problem, he would request reports on the matter for a specified period in the special section. It was a "super highlights" area for important matters to be brought to his attention

Periodic Market Research Report

PERFORMANCE HIGHLIGHTS

All projects continue on schedule except for a slight delay on No. 110, which was originally planned to be completed last month. Costs continue to be greater than planned due to the hiring of a new project manager and greater than expected travel expenses on Project No. 108.

PROGRESS ON MAJOR PROJECTS

Project Number	
No. 108	The report on the potential Canadian sales market for electric tools was submitted this month. Report recommended that the market not be developed at this time because of heavy marketing and distribution costs.
No. 110	The study of the deluxe line of electric drills disclosed wide interest in redesigning the handle to facilitate use and eliminate a potential shock hazard noted by some customers. The report of the study is being prepared and will be submitted next month.
No. 111	The study of the potential sales market for small electric saws continues. Questionnaires have been developed and will be used in interviews with jobbers and distributors during the next three months.
No. 119	The study of competitive lines marketed by Craig Electric Co. and Gar-Jon Corp. was started this month. The study is scheduled to be completed in four months.

KEY INFORMATION

	Project Summary		
	Actual	Plan	Last year
Projects Resulting in Products with			
Sales potential over \$2 million per year	2	2	1
Sales potential under \$2 million per year	3	5	4
	Actual as Percentage of		
	Actual	Plan	Last year
Operating Costs (thousands)			
Month	\$ 23	110%	116%
To date	\$168	103%	110%
Twelve-month Sales of Products Developed in Last Five Years (millions)	\$ 8.6	89%	110%

EXHIBIT 5

Example of a Key Item Report to Vice President—Marketing

during periods of special pressure.

The success of key item control systems has been dramatic. One executive told us, "For the first time I feel that I really have my finger on the important things happening in the company." An interesting by-product was pointed out by an official of another large company. He stated, "The reports help me in evaluating my people. It is very revealing to note what they consider important. Some worry about little problems and miss big ones; others don't seem to understand the problems or their causes very well."

Key item control systems are just starting to gain popularity. As their results become more apparent and widely discussed, the time may arrive when total information systems will rarely be discussed without reference to a key item control system to organize the output data for effective use by senior executives. More detailed reports will still exist, but these will be recognized as what they are, information for middle management, and will rarely reach top management. By that time many computer systems will be programed to do much of the work of compiling

key item reports and making the preliminary analysis of problems and interrelated factors.

Executives may still have reason to complain to their associates that they don't have enough time. It is hoped, however, that one unnecessary time waster will not be a stack of reports on their desks and a nightly schedule of report reading. Rather, it will be due to the pressure of planning and directing the various programs involved in running a successful company. This is where the senior executive's valuable time can contribute most to the performance of the company.