The Controlling Concept

A Practical Guide to Effective Management Control

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The effects of this portfolio of measures must be updated continuously as part of the forecasting process. To this end, the employees responsible for the measures must report the implementation status. Management is thus kept up-to-date on re-prioritisations or any other need for action in relation to the portfolio of measures. Status reporting also offers a further psychological effect: The employees responsible are more likely to submit a realistic plan for measures for which they know they will have to submit regular implementation reports later on. Consistent tools and templates must be used to make it possible to compare measures. This includes, for example, clearly defining key ratios which must be planned.

4.6.3 Lessons learned

Planning and forecast redesign greatly increased management and Controlling satisfaction. Both planning and forecasting have become valuable management tools. Planning is used to set ambitious but realistic objectives, and to define measures to close possible gaps in relation to the targets. By contrast, forecasting is a prediction tool used to continuously and objectively evaluate short-term economic development. It was also possible to significantly reduce planning costs, because the values used are no longer determined in detail using complicated, coordinated, bottom-up processes. Instead, they are systematically deduced from a 5-year target value.

The redesign was defined and implemented over a period of 12 months and required a significant investment. The key success factors for the implementation were

- a structured change management, and
- the use of a new system to implement the IT requirements.

These made it possible to meet the ambitious project deadlines, and also to ensure that the changes to the planning and forecasting system are not just communicated but also sustainably integrated into the company's organisation.

After the system was implemented, only minor changes were made to the original design. The encouraging fact that the ambitious 5-year value was almost reached as early as the second year has triggered further design-related discussions. These are currently focused on when the multi-year target value can or should be adjusted.

4.7 Organisational checklist for managers and controllers

Derive operative planning from strategic planning.

Link operative planning (e.g. sales planning) with finance planning (P&L, balance sheet and cash flow statement).

Pay attention to the design characteristics of your budgeting system (differentiation and completeness, bindingness, budget level, budget slack, budgets and strategic plans).

Design your budgeting process in line with the required characteristics (vertical coordination of budget planning, chronological coordination of budget planning, level, frequency and method of control, tolerance limits, flexibility).

Use a rolling forecast which always has the same horizon.

Also use non-monetary content in your forecast.

Consider forecast values in your planning.

Further reading

If you would like to find out more about planning in general, the following might be helpful:

Hahn, D., Hungenberg, H. (2001), PuK – Wertorientierte Controllingkonzepte, 6th ed., Wiesbaden 2001.

Anthony, R. N., Govindarajan, V. (2006), Management Control Systems, 12th ed., Boston 2006.

If you would like to find out more about modern planning, read:

Gleich, R., Kopp, J., Leyk, J. (2003), Advanced Budgeting: better and beyond, in: *Horváth, P., Gleich, R. (Hrsg.),* Neugestaltung der Unternehmensplanung, Stuttgart 2003, pp. 315–329.

5 Financial Management and Financial Controlling

5.1 Chapter objectives

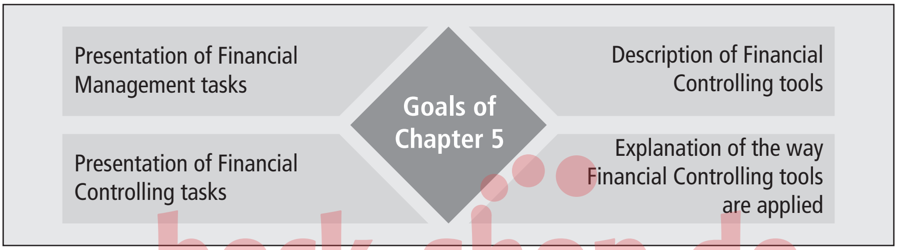

Fig. 5.1: Chapter objectives

This chapter aims to introduce the reader to the Financial Management/Financial Controlling component. It starts by setting out the tasks of Financial Management/Financial Controlling, followed by a presentation of the Financial Controlling tools and their application.

5.2 Introduction

A company can only function as a going concern if it is financially solvent. Sufficient financial resources are an essential prerequisite for establishing, building, growing and operating the company. A company's success is also primarily dependent on financial resources, as its aim must be to increase initial investment.

As a result, planning, management and control of financial resources are eminently important corporate management tasks which require specific support from Controlling. Financial Management is responsible for securing liquidity in the short term and in the long term, and as such for handling the mentioned tasks. Financial Controlling plays an important role by providing both tools and information to support Financial Management in performing its tasks. It is of key importance for Financial Management and Financial Controlling to cooperate efficiently. This begs the question of how to organise interaction between Financial Management and Financial Controlling effectively.

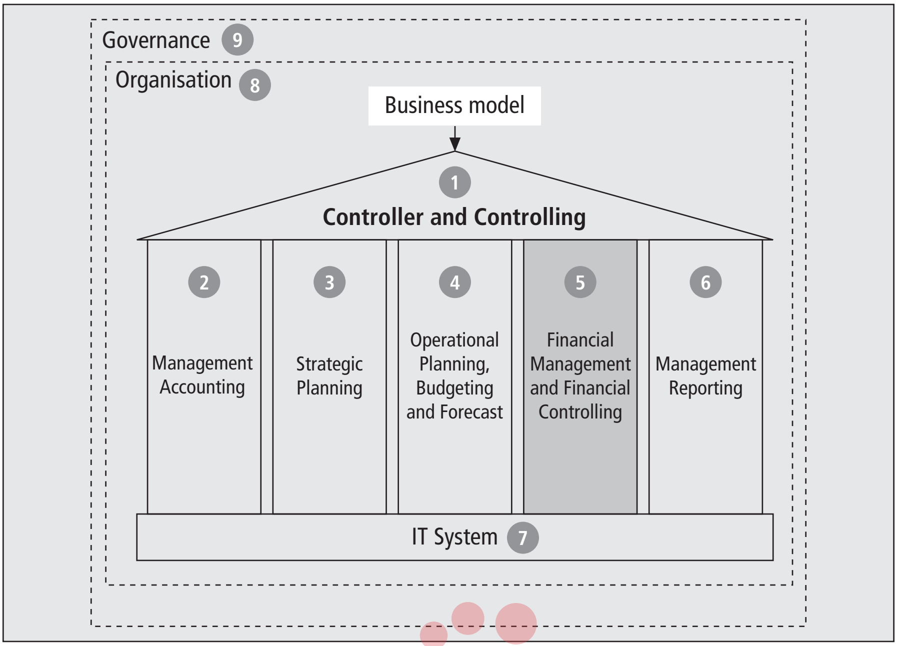

Fig. 5.2: Classification of the chapter in the "House of Controlling"

Therefore, this chapter describes which tasks Financial Management has and how Financial Controlling supports Financial Management in performing these tasks. It also introduces Financial Controlling tools and how to use them.

5.3 Designing effective Financial Management and Financial Controlling

Financial Management is responsible for ensuring the company's liquidity both in the short term and in the long term. Financial Controlling provides both tools and information to support Financial Management. **Fig. 5.3** illustrates the interaction between Financial Management and Financial Controlling.

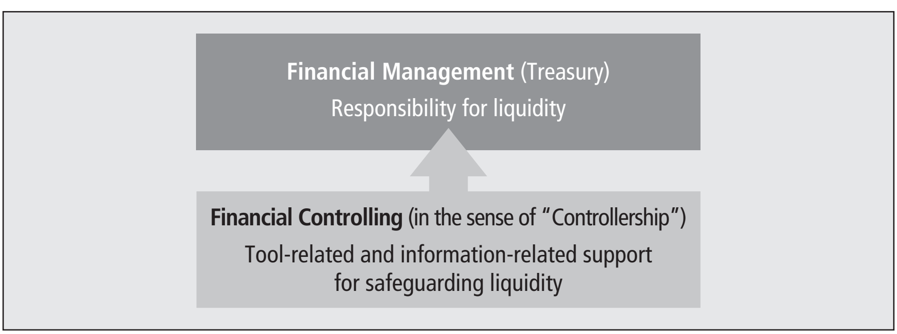

Fig. 5.3: Interaction between Financial Management and Financial Controlling

How Financial Management and Financial Controlling should be designed strongly depends on a company's size and industry. Nevertheless, tasks can be split based on some general principles. The section below describes the tasks of Financial Management and Financial Controlling in more detail. In particular, it explains how Financial Controlling can support Financial Management in securing liquidity. It also gives a detailed overview of the most important tools used by Financial Controlling in practice and how they are applied.

5.3.1 Financial Management

Liquidity is essential for ensuring a company's continued existence. Corporate Financial Management must focus on maintaining the company as a going concern. As a result, the core task of Financial Management is to ensure liquidity in the long term.

This core task can be broken down into the following three sub-tasks:

- **Situational safeguarding of liquidity:** This deals with safeguarding liquidity on a day-to-day basis by coordinating payments.
- **Short- to medium-term financing:** This is focused on calculating the capital requirement in consideration of risks and obtaining financing from free internal funds, external equity and third-party financing.
- **Structural safeguarding of liquidity:** Ensuring that a financial structure in line with the strategy is in place.

Financial Management is responsible for managing the Finance division itself and for financially coordinating all processes within the company. A company's processes must be coordinated financially in order to record, coordinate and control the impact of operational business processes on payments, capital retention and financial success.

Three development levels of financial management can be identified based on these core tasks (cf. **Fig. 5.4**).

From a **short-term operations perspective**, the main objective must be to continuously safeguard liquidity. Financial Management is focused entirely on liquidity.

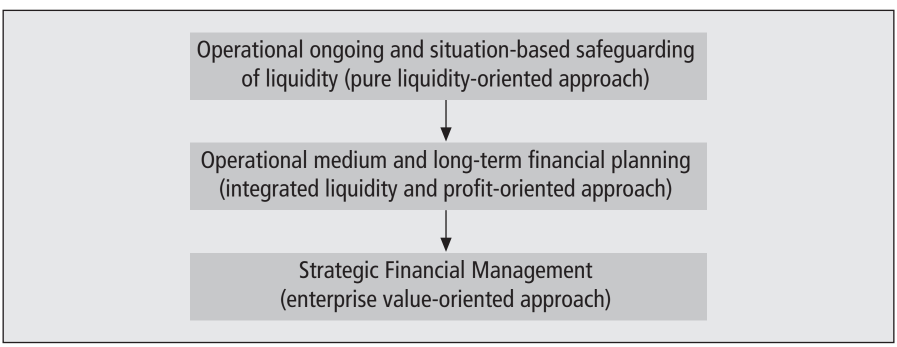

Fig. 5.4: Development stages of Financial Management

How do you ensure long-term liquidity in your company?

From a **medium- to long-term operations perspective,** liquidity must be viewed as a consequence of decisions resulting in payment. Financial Management approaches can be found in all company business functions. Accordingly, Financial Planning must be integrated with the other corporate planning components, such as by using integrated financial and results planning. Financial Management is focused not merely on liquidity but has an integrated focus on liquidity and results.

The **strategic stage** of Financial Management is dominated by the aim of sustainably increasing company value. This includes the capital structure, obtaining equity and third-party financing, and designing the corporate strategy taking financial aspects into account. This stage no longer has an internal focus but instead also considers the external (capital) market. Financial Management is focused on increasing enterprise value.

In corporate practice, Financial Management tasks are closely linked to operational management tasks (cf. **Fig. 5.6**).

Investment Management comprises real and financial investments and investigates how best to invest. Real investments involve acquiring material assets (property, machinery, etc.), whereas financial investments are investments in financial assets. Financial assets include so-called participation rights (e. g. shares) and creditor rights (e. g. bonds).

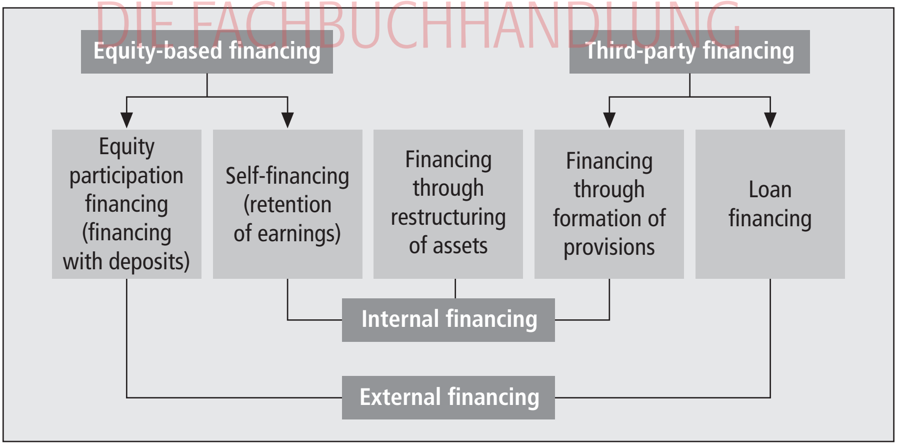

Fig. 5.5: Financial Management

Financial Management is made up of internal and external financing and thus determines how and by what means financing can be obtained (cf. **Fig. 5.5**). It is important to distinguish between internal and external financing. These two types of financing can be further split into equity financing and third-party financing. In internal, equity-based financing, the company provides the financing itself. Existing equity is used for the financing. By contrast, internal third-party financing involves raising third-party balance sheet capital by reversing existing provisions, for example. External, equity-based financing takes the form of equity participations financing. For instance, a capital increase can be used to obtain the necessary funds. External, third-party financing takes the form of loan financing. For example, a loan may be taken out to finance an acquisition.

Financial Risk Management is used to identify, analyse and evaluate a company's financial risks. To be precise, this involves defining criteria based on which risks can be evaluated, as well as methods to identify risks. In addition, responsibilities must be assigned, resources made available to avert risks, communication channels defined and staff trained (cf. Section 9.3.1 on Risk Management).

Cash management is concerned with how to organise payment transactions and how to invest and obtain liquid funds. It therefore concerns all corporate tasks aimed at safeguarding liquidity in order to maintain the company as a going concern.

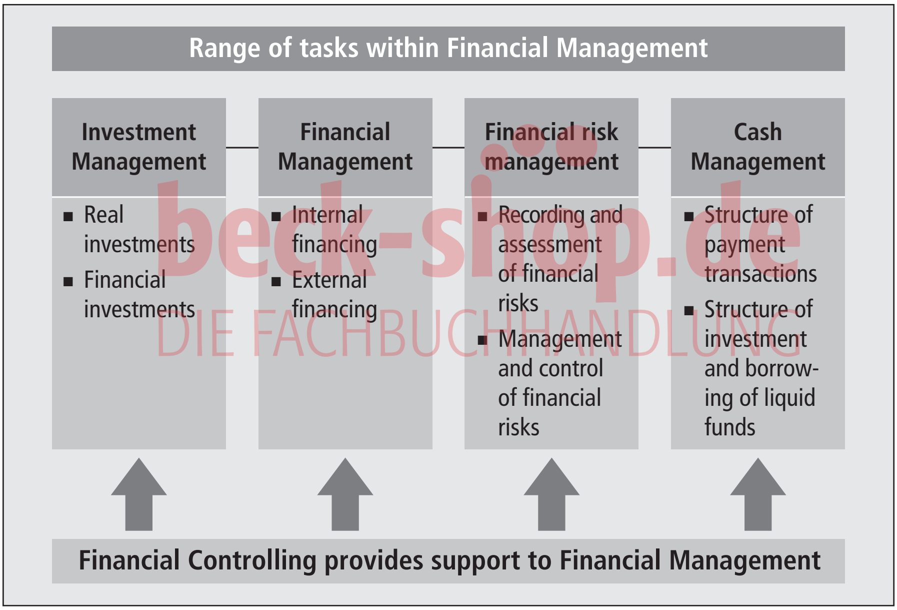

Fig. 5.6: Financial Controlling supporting Financial Management

The tasks depicted in **Fig. 5.6** must be specifically adapted to a company's size and structure, its industry and the geographical scope of its operations.

Financial Controlling provides specific tools to assist with individual Financial Management tasks. These are determined based on the Financial Controlling process set out below.

Are all fields of activity covered by your finance management?

5.3.2 Financial Controlling

5.3.2.1 Tasks of Financial Controlling

Financial Controlling is tasked with supporting the management of the company and, in particular, Financial Management with performing their task of safeguarding liquidity while meeting the requirements of the different business functions in relation to profits.

In particular, this includes the following tasks:

- **Coordinated support for financial planning and control:** This task comprises both periodic and case-by-case assistance (e. g. during investment projects). It relates both to operative and to strategic planning.
- **Ensuring financial information supply:** Comprises all information for financial and company management relating to safeguarding liquidity, financially evaluating all company processes and coordinating the liquidity target with the target result.
- **Setting up and developing the Financial Controlling system:** Comprises all topics related to tasks, processes, organisation, tools and IT support.

How are finance management and finance Controlling organised in your company? Which tasks do both functions carry out?

Like Financial Management, Financial Controlling has a dual focus. As a result, its tasks comprise departmental support for Financial Management, as well as support during the external coordination of liquidity and result targets.

The Financial Controlling process must be organised as a planning and control process with organisational design being strongly context-dependent. This consists of creating, implementing and monitoring the financial plan (cf. **Fig. 5.7**).

The hierarchy levels of the Financial Controlling planning process are the same as those of the overall planning process:

- long-term/strategic financial planning
- medium-term operative financial planning
- short-term operative financial planning

These planning stages are supplemented by day-to-day liquidity management and control.

The relevant financial planning deadlines are based on the product cycle and production process (e. g. companies following current fashions will have a shorter planning horizon than investment business).

The Financial Controlling process must be coordinated with the general planning and reporting process. Alignment across different business functions poses a particular coordination challenge.