Managerial Methods 9

The difference between a manager and a leader: A manager does all things right. A leader does the right things.

Opening Vignette

Michelle Johnson and Howard Dawson were not in a very good mood. They had just come back from the bank where the manager had told them in a rather direct way that they needed to decide on a strategy and not just react to whatever was happening.

"He was rude! Very rude!" complained Howard, running his hand through his luxuriant beard. "Just because I've never heard of a BCG matrix doesn't mean that I'm bad at running our business."

"We have been successful," Michelle threw in, "but things haven't been going that well recently, though, have they?"

Howard and Michelle had started a bicycle company 5 years ago. Keen cyclists living in Berlin, they had noticed that there was as big demand there for fixies—bicycle with a single, fixed gear—as that was in Hoxteth, a trendy area in London where they used to live, and not as many producers, so they had started producing this kind of bike themselves. Things had gone so well that they had quickly expanded their range. They had added mountain bikes to their offering and they now also produced skateboards and scooters. Their share of the skateboard market was very small, however, even though Michelle put a lot of time, money and effort into the development and marketing of their products. The same was unfortunately true of the mountain bike market. On the other hand, they had a good share of the scooter market, which was growing an amazing 25% per year, and they had just under 20% of the Berlin fixie market.

"I'm afraid the fixie market isn't growing at all," said Howard, admiring his new tattoo.

P. Eichhorn, I. Towers, *Principles of Management*, Springer Texts in Business and Economics, https://doi.org/10.1007/978-3-319-70902-4_9

"But the scooter market is growing very fast and we have as big a market share there as we do of the fixie market, even if the overall market for scooters is small right now;" Michelle smiled. "We could do something there."

"So. . . should we get out of the skateboard market?" asked Howard.

Michelle reluctantly said, "Yes, I think we probably should. We'll put more money into the scooters. And we should keep spending on the fixies at about the same level, because there'll always be hipsters who want one."

"Why are you looking at me like that?" asked Howard as he turned on his Apple notebook.

"No reason," said Michelle innocently.

One week later they were back talking to the bank manager and told him what they were considering.

"Excellent," he said, "you've just done a BCG portfolio analysis and produced a matrix."

"What?" cried Michelle and Howard simultaneously.

9.1 Management

9.1.1 Approaches to Management

There is no escape from the principles of economic efficiency and effectiveness. They are applicable to all economic agents: households, enterprises, associations and administrations. The managers of these economic entities are ultimately those who are responsible for identifying inefficiency and ineffectiveness and for turning things around. Depending on the economic agent, the leadership role is taken by individuals and/or governing bodies. In colloquial speech, we talk of heads of the household, chairs (many organisations use this gender-neutral term instead of chairmen and chairwomen) of foundations, managing directors, directors, presidents, spokespersons, chief officers, chancellors, ministers, rectors, heads of administration departments, and so on. They all have in common that they stand at the top of an institution, either alone, or together with one or more colleagues on a board. From the point of view of the discipline of business administration, management is a decision-making factor; it is part of the personnel factor of production, and it combines production factors to work towards chosen goals. This involves setting targets, making decisions, implementing actions and monitoring; in a nutshell, **management consists of setting targets and implementation**. In a narrow sense, management is related to employees and staff (people management) and in a broader sense to institutions (business management, top management, managing a department, plant management, managing an office). It is interesting to note that the distinction between management and leadership is not made to the same extent in Germany as in the English-speaking world.

Most research into management has focussed on the management of firms because of their size, complexity, the amounts of money involved and the importance of good management in a competitive environment. A fundamental question

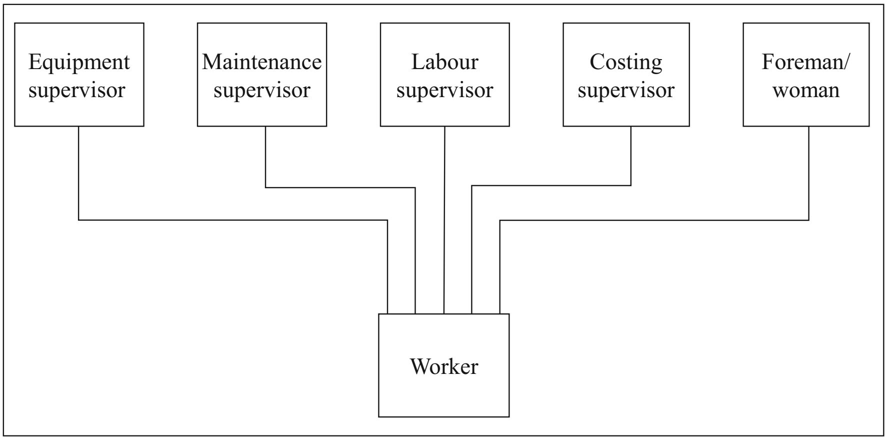


Fig. 9.1 Functional system

is: What should top managers do? Its answer requires identifying the areas, problems and issues managers (should) deal with, and how they (should) deal with them. There are a number of approaches to management, each with a different focus.

The first approaches that gained worldwide attention were those of the American engineer Frederick Winslow Taylor (1856–1915), who is regarded as the founder of Scientific Management, and of the French engineer Henri Fayol (1841–1925) with his studies on the organisation of firms and administrations. Both focus on the organisation of responsibilities, more specifically on systems of competences and of authority, as well as on the organisation of hierarchies. Taylor proposed the **functional system** (Fig. 9.1) that is characterised by direct supervision of workers with multiple lines of authority based on the principle of the shortest distance. Fayol's proposal was for a **hierarchical system** (Fig. 9.2). In this system, managers higher up ensure that instructions are given in a coordinated way to subordinates through the principle of unity of command—there is a single line of authority. Both approaches can be found in management as it is practised today (Fig. 9.3), with the functional structure dominating because it makes it easier to define competences and responsibilities; one reason for this is that each employee has a single supervisor.

The management structures of modern corporations and administrations are very complex. Many of them include supporting staff units (such as HRM and legal departments) which exist to provide support to line managers and have only limited direct authority. In order to make a large organisation manageable by top managers, it is necessary to group the departments and business units in the organisation in a meaningful way. This can be done on the basis of type of customer, geography, product or function. As mentioned above, the functional structure dominates in organisations because of the unity of command. Matrix organisations go against this principle, because they combine product organisational structures with functional structures so that individual employees can have two (sometimes even more) supervisors.

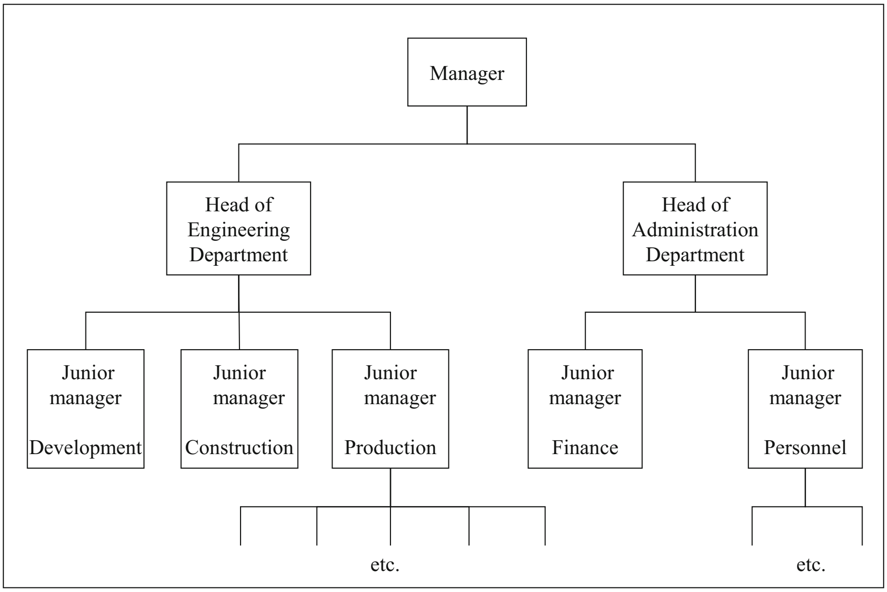


Fig. 9.2 Hierarchical system

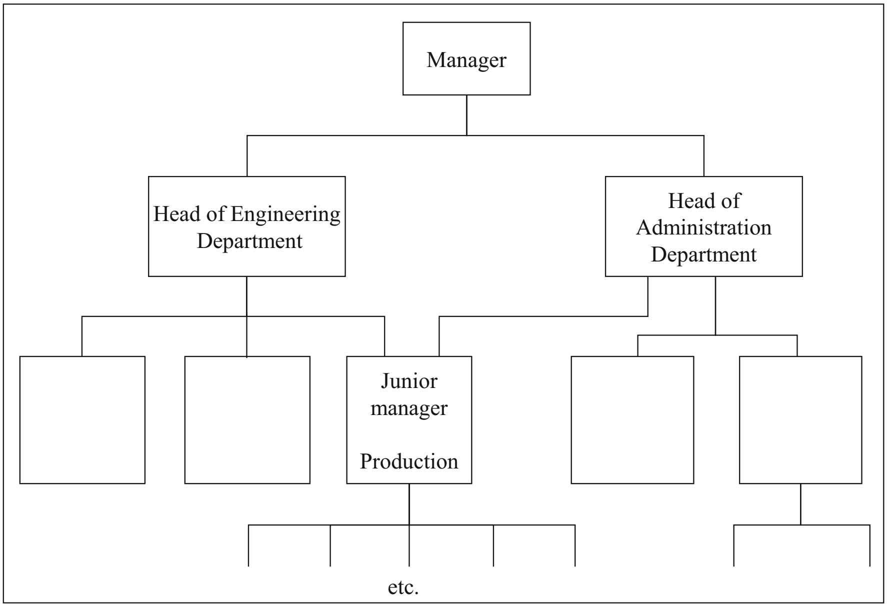


Fig. 9.3 Hybrid system

It is interesting to look at two classic management approaches developed in Germany because they are still highly relevant for corporate policy. One is by Curt Sandig (1901–1981), the other by Konrad Mellerowicz (1891–1984).

According to Sandig, managing a company has two aspects: **business policy and management policy**. For him, business policy consists of generating ideas, setting goals, making fundamental and routine decisions, and taking on responsibility. He argues that the goals of firms are to maintain and increase their economic power. The search for profit and security should take place as a dialectical process between "pushing forward" and "holding back". All the fundamental decisions that have to be made are related to the establishment phase of a firm's life (in particular the purpose of a company, choice of location, size, funding, legal form, recruiting and structuring the management team, organisational structure, getting on to the market). The routine decisions made within this framework are about issues such as personnel policies, purchasing policies, sales policies and financial policies. Decisions have to be made and the people making them are accountable for them to the law, shareholders, creditors, employees other stakeholders and their own conscience. In contrast, management policy is mainly responsible for the implementation of ideas, for developing plans, for organising—in essence, for turning decisions into reality.

Sandig's approach has the advantages that it allows the interdependencies of corporate policy decisions to be identified and that it provides systematic help to managers with the classification of complex leadership problems. However, it does not present concrete solutions regarding which goals to set, how to optimise decisions and how to choose the best alternative for implementation.

Konrad Mellerowicz' approach also developed out of applied business management studies but it emphasises applicability in real business life, and his aim was to establish academically sound rules to improve decision-making. The management of a company involves two tasks; the first is **corporate policy making**, which is taking fundamental decisions that affect the entire company. The second task is creating the conditions for management, or in other words, for the **implementation** of corporate policy via basic management functions: organisation, information, planning, coordination and supervision. Corporate policy consists of bringing together three kinds of sub-policies:

- function-related sub-policies, dealing with areas such as sales, production, purchasing, inventory management, personnel and finance,
- non-function-related sub-policies in such areas as costs, prices, balance sheet, profit, maintenance of asset value, dividends, tax and marketing, and
- sub-policies related to the whole enterprise, like company policy.

A theory is needed to develop decision-making rules that are universally valid. Such a theory can only be established by going beyond descriptions, even if they are the result of hard won experience; it is necessary to turn assertions that have been empirically derived and verified into laws, and then combine them on the basis of logic. However, the Mellerowicz approach is only partially based on such a theoretical foundation (for example, his use of cost and price theory as a theoretical basis for an entire corporate policy), so that its practical value is limited.

More recent theoretically oriented fundamental approaches have tried to correct this shortcoming. Again, two that have been given a positive reception in academia and in practice will be outlined here. One was published by Hans Ulrich (1919–1997), the other by Peter Ulrich (born 1948) and Edgar Fluri (born 1947).

Ulrich's approach is based on systems theory. A firm is viewed as a system of circuits and corporate policy represents the upper circuit. It must be based on the values of senior management and the state of the environment and the firm. The tasks of corporate policy are to make fundamental long-term decisions, to establish capabilities and corporate strategies, to implement and supervise operational measures, to adapt to developments in the environment and to generally define what the firm offers on the market. Decision criteria for corporate policies are: validity for many different management situations, materiality (not being concerned with details), validity for the long-term, comprehensiveness (by taking into consideration capabilities and strategies), truth, feasibility, consistency and clarity. In short: decisions should be coordinated and unequivocal. Corporate policy provides the mid-level circuit—planning—and the low-level circuit—arrangement—with three documents. A mission statement is a short document that captures the fundamental goals and principles of a company. A company concept explains what the business is going to do, how it will do it, and how all this will be financed. It may include statements of the social values of the company. The third document is a management concept, in which the goals and principles to be used in running the company are described. All circuits are connected by information gathered from monitoring and control activities so that deviations from planned targets can be identified and improvements be made.

This approach characterises corporate policy as the shaping of circuits. Corporate policy is a process of problem solving, which requires certain structures, instruments and information. Hans Ulrich's approach has a strong theoretical base, and can at the same time be used in practice. However, it does not sufficiently deal with conflicts of interest, how groups are formed and goals are set.

Peter Ulrich and Edgar Fluri do consider these issues. They argue that **corporate policy is derived from corporate philosophy** and emerges from the debates about values, interests and goals between those inside the firm and those on the outside who are in some way affected by it. Three internal stakeholders—owners, management and employees—and five external stakeholders—providers of debt capital, suppliers, customers, competitors, the state and society—can be identified. Power relationships between stakeholders and the value systems of the dominant groups determine how the process of setting the corporate policy runs and where it ends. Setting corporate policy therefore involves conflict management and consensus building. The nature of the decision-making role of management emerges from this process, as do the way a company behaves in the market, its approach to ecology and, in the case of a firm that does business internationally, its approach to development issues. The norms that develop are naturally also influenced by the current state and future developments of the company and its environment; coupled with the relevant data, these become part of corporate planning. Corporate planning and monitoring, the process of organising, management and management development then provide the basis for the implementation of corporate policy.

This approach emphasises the balancing of interests between the firm and what is expected and required from it with regards to the social and ecological environment. Depending as it does on power relationships, the outcome is uncertain. If a balance cannot be struck, the company may become marginal and exit the market. The nature of these processes means that there must be a regulatory framework for corporate policy that concerns itself with the exertion of power and conflicts.

Special Note Spurred on by the German business community, a government commission developed the **German Corporate Governance Code** in an attempt to regulate conflicts of interest and to clearly define responsibilities within companies. German companies have a dual board management system—the Management Board is responsible for managing the company and the Supervisory Board appoints, advises and supervises the Management Board. Some statements from the latest version of the Code (June 2017) illustrate its themes:

3.5 Good corporate governance requires an open dialogue between the Management Board and Supervisory Board as well as between the members of these individual Boards. Comprehensive observance of confidentiality is of paramount importance in this regard.

3.8 The members of the Management Board and Supervisory Board comply with the rules of proper corporate management. If they violate the duty of due care and diligence of a prudent and conscientious manager or Supervisory Board member, they will be held liable to the corporation for damages. [...]

4.1.1 The Management Board assumes full responsibility for managing the company in the best interests of the company, meaning that it considers the needs of the shareholders, the employees and other stakeholders, with the objective of sustainable value creation.

The management approach developed in the following sections is based on an understanding that politics is a force that shapes everything. In the past, **politics** was always understood as being related to states, cities, churches and other forms of community. For Aristoteles (384–322 BCE), politics deals with the organisation of communities and their constitution. For Aurelius Augustinus (354–430), it is the management of change, for Niccolo Machiavelli (1469–1527) seizing and using power, while for Max Weber (1864–1920) politics is the struggle for power or influencing how power is distributed. From these various understandings it is possible to draw some conclusions about the role politics has and the form it takes in institutions, be they companies or other kind of economic entity, such as public administrations.

Politics has three aspects. First, it has a functional dimension—**policy**—that sets goals and solves problems. Second, it has an institutional (formal, systemic) dimension—**polity**—which revolves around the organisation of politics and its rules and regulations. The third dimension is process-related and is **politics** in a narrow sense, dealing with asserting interests and with conflicts.

The following sections show the role politics—in all its forms—plays in firms, analysing corporate policy as an example. This management approach with its orientation to politics can also be applied *mutatis mutandis* to other economic agents. It is based on reaching a desired state, and can therefore be called a **goal-based management approach**. The goals that are set determine the management system, the management process and the challenges posed to management competences.

9.1.2 Management Goals

The most important goals of a company are those of the corporate policy; from this are derived all other goals. The system of different goals can be shown in a matrix that combines production factors and operational functions (Fig. 9.4).

Additional **goal areas** are created when factors or functions are combined with products. When looking at individual products or groups of products it is useful to know, for example, the proportion of total costs represented by individual production factors, or which process steps are involved in the manufacturing of a good. It is possible to create a **goal cube** by adding to the goal matrix the organisational

Functions / Factors	Procurement	Transport	Inventory management	Manufacturing	Administration	Marketing
Personnel	recruiting goals	mobility goals	personnel capacities goals	labour costs goals	overhead costs goals	communication goals
Capital	financing goals	payment transactions goals	tied-up capital goals	capital turnover goals	liquidity goals	pricing goals
Material	material quality goals	transport efficiency goals	warehouse capacity goals	manufacturing productivity goals	control costs goals	product quality goals
Energy	energy reduction goals	energy safety goals	energy reserve goals	energy peak load goals	energy mix goals	energy consumption goals
Services	service procurement goals	on-time goals	service call goals	make or buy goals	insourcing & outsourcing goals	customer service goals
Legislation	patent acquisition goals	risk reduction goals	patent length goals	rights management goals	brand protection goals	sale of rights goals
Nature	resource conservation goals	environmental protection goals	waste site provision goals	recycling goals	safety of waste disposal goals	PR for nature protection goals

Fig. 9.4 Goal matrix with factors and functions

units (divisions, departments, profit centres, cost centres, etc.) responsible for setting and achieving goals.

One of the main problems of corporate policy is to devise a goal system (see Sect. 5.1.2) from the different kinds of goals (see Sect. 5.1.1) while taking into consideration the relationship between them. Such a goal system needs to serve as a guide for concrete goal concepts (see Sect. 5.1.3) and at the same time it must be aligned with the business principles (see Sect. 5.1.4). The process for the **formation of goals** can only succeed when it is both top down and bottom up, which means that managers from all levels must be involved. This ensures that the individuals involved identify with the goals and this then motivates them. When formulating goals, the members of the top-management bodies (e.g. a German management board) and also the members of the supervisory bodies (e.g. a German supervisory board) emphasise **corporate goals** in particular, e.g. the survival of the company, profitability, product and service quality, high innovation rate, public image, company growth, turnover and market share, power and influence on the market, satisfying customers, social responsibility, being environmentally friendly. Everyone in the organisation has goals related to their situation and area of responsibility; the lower down in their hierarchy one goes, the narrower and more specific the goals.

It is however necessary to go beyond goal systems; standards need to be established and finally **goals defined and agreed**—if goals are not set, they cannot be reached. When the goals that are non-economic in nature are being set, there are no numbers that can be used for measuring, so alternative indicators need to be found (see Sect. 5.5.1), different measurement methods need to be applied (see Sect. 5.5.2) and different measurement scales need to be used (see Sect. 5.5.3). If it is not possible to set a specific goal, a **target range** must be identified, with upper and lower limits.

Implementation goals are often neglected even though they are essential to the achievement of overall goals. There are two different kinds; in one of them an assignment is delegated, in the other directives are issued. In **management by objective**s, when an **assignment is delegated**, methods are not specified and the employee is free to choose her own approach, which requires firstly the ability to think independently and holistically, and secondly knowledge of the methods and resources that might be used. In contrast **management by directive** does not leave the employee with any scope for making decisions or room for manoeuvre. Interim goals are given which must be met in order to achieve the overall target. The instructions can be made on a case-by-case basis or exist for general use. According to the substitution law of organisation of Erich Gutenberg (1897–1984), taking decisions on a case-by-case basis should be replaced by the introduction of general rules—if possible—as this promotes simplification and standardisation, i.e. less bureaucracy. This approach is mainly appropriate for recurring routine work, but it should not be inferred that it applies only when there are large amounts of work involved, as general rules can even be found for isolated cases that will (hopefully) never occur—this is the foundation of disaster management.

9.1.3 Management System

A management system comprises all the rules that apply to the management tasks in an organisation, including those of top management, the group that is in charge of these activities. Like every system it exists through its elements and their combination. The starting point is a goal system with formal and substantive goals that are formalised in financial and performance concepts, all underpinning an orientation that derives from the leadership philosophy, organisational culture and a unique corporate identity (see Chap. 5).

Figure 9.5 shows the most important elements of the management system; they develop from management goals—in firms, these are the corporate goals—and affect all other areas related to management—the management process, management competences and controlling.

Management tasks can be divided into four categories:

- making decisions related to company foundation, survival, expansion, modernisation and management,
- establishing and implementing corporate goals, determining the orientation and goal system,

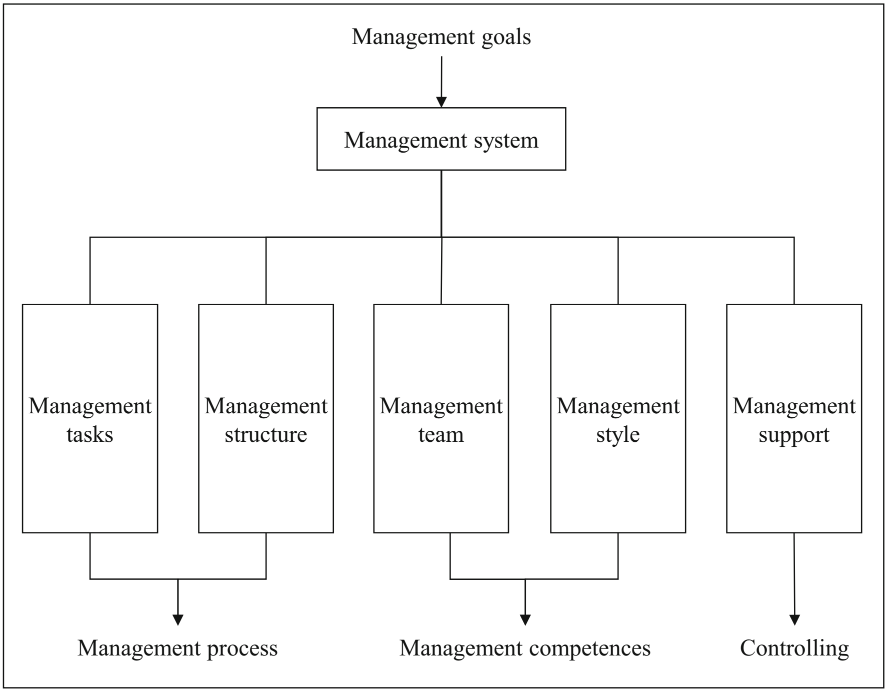


Fig. 9.5 The elements of management systems

- making decisions about the production programme, the deployment of human, financial, organisational and other resources, and quality assurance, and
- carrying out all vital ongoing tasks of management.

Management tasks are primarily concerned with organising and directing. Personal and political interests, power and business logic influence the way in which tasks are interpreted and carried out, as do general conditions that cannot be influenced by managers.

Management tasks can differ, depending on the **management structure**, which describes how the management team is organised, i.e. which responsibilities are assigned and how they are assigned. Many factors play a role in this: the industry in which the firm operates, the firm's size, structure, culture, ownership structure, corporate governance system (either a single tier board system, as in the United Kingdom, United States and Japan, or the German two-tier board system with a management board and a supervisory board), legal form and right of co-determination.

A further consideration is the management culture, i.e. whether senior managers work more as autocrats or as team players. Thought must also be given to the **span of control**, which describes how many direct reports a manager has, and to the extent to which responsibilities are combined or split up, and centralised or decentralised.

Management teams take many forms. In firms, they are made up of the members of the board of directors and the middle managers and supervisors who are to be found lower down the hierarchy in all areas of activity. Executives are employees with entrepreneurial responsibilities, for they have a significant influence on corporate policy and possess considerable scope for decision-making. Because of the nature of their tasks, executives also represent interests (those of the shareholders) that can be diametrically opposed to those of the rest of the employees. In Germany, the term 'executive' (*leitender Angestellte*) is a legal concept, bringing with it certain rights and obligations that are laid out in various laws. The human resource departments of larger companies often establish career development and training programmes for managers, paying special attention to those junior managers who are seen as representing the next generation of senior managers—these efforts are usually referred to as **talent management**.

Management style stands for the ways in which managers get their subordinates to do what they want them to do. There is a continuum of styles, from authoritarian to participatory, and the aim is always to motivate subordinates to perform. The goal is to find **an** ideal management style; there is not **one** ideal style, because needs vary according to time, place and situation—the task in hand and people involved influence the management style that should be used. A company dealing with research and development with creative personnel will be more successful if a participatory or cooperative leadership style is used, whereas a company that is specialised in the disposal of waste that contains asbestos or is radioactive needs, for safety reasons, to be managed in a more authoritarian way. In critical situations, such as a fire, the person in charge needs to act swiftly and in an unbureaucratic way, which implies a more authoritarian style. It is important to be aware that subordinates have different needs. Some prefer to be told clearly what they should be doing, in which case an authoritarian management style makes sense, while others perform better if they feel they can participate in decision making. Managers need, then, to take into account the situation and the needs of their employees when deciding on the appropriate management style.

Management styles are influenced by organisational culture and also by national culture. Geert Hofstede (born 1928) developed a series of dimensions on which cultures can be measured. One of them is power distance; in cultures with a high power distance (e.g. Guatemala and Poland), employees do not expect to have much input into decisions, so the typical management style is authoritarian. On the other hand, low power distance cultures such as Sweden and the UK produce expectations of participatory management styles.

Incentives are related to the management style; they are sometimes used to achieve feelings of group belonging and to influence the working atmosphere. Similarly, the delegation of certain tasks and responsibilities can also serve as incentives, as can opportunities for training and promotion. Last but not least, compensation can be an incentive; often forgotten is that pay is not the only motivator for some people, so rewards should match their wishes.

Finally, a management system needs **management support**—this is mainly provided by information and communication technology. The information system has to gather data and turn it into information, supplying it in a user-friendly way (the right time, the right form, the right quantity and the right place) so managers can make well-founded decisions. **Information and communication technology**—hardware, software and complementary services—has led to huge improvements in productivity.

9.1.4 Management Process

The management process forms a control loop that makes it possible to track the different phases of the management tasks that are being carried out in management structures. Courses of action can be broken down into a sequence of steps starting with **problem analysis** (which often becomes an analysis of weak spots), followed by the **development of solutions**, which consists of information gathering, identifying alternatives, and then using impact analyses to evaluate them. This is followed by **decision making**, i.e. choosing the best alternative, **operational planning,** which involves either establishing a project programme for the chosen alternative or its inclusion in existing programmes, with the necessary detailed budgeting, **implementation**, and finally by **evaluation** using the performance indicators that were established earlier in the process. The process itself should also be evaluated, of course.

Figure 9.6 shows these steps and the questions that should be asked in the course of this process.

Feedback links these steps to a control loop. If the above six steps—there are many more in reality—are simplified by merging the first four into a single planning phase, by viewing implementation as an execution phase, by viewing the evaluation

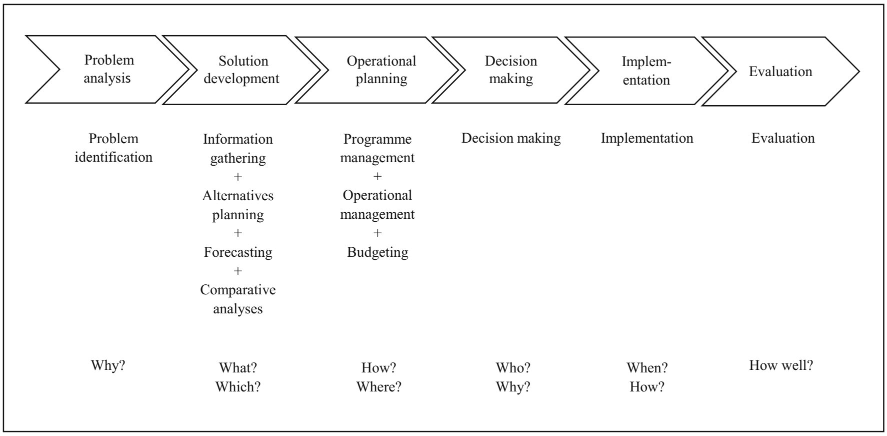


Fig. 9.6 Process steps of management

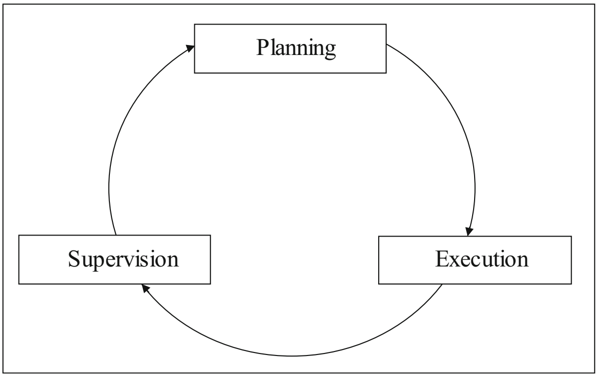


Fig. 9.7 Management process as activity circuit

phase as a supervision phase, and if the outcomes are then linked with the planning phase, the management process takes the form of an activity circuit.

Figure 9.7 presents the **primary circuit**; around each of these phases are three sub-phases, forming **secondary circuits**.

The **planning phase** itself needs to be planned, as numerous approaches to planning exist. Is planning to take place centrally or decentrally, bottom up or top down, as general planning or detailed planning? Is it to be based on sampling or should information be gathered from a full survey? Is planning to be done in-house or entrusted to a third party? The planning phase involves the generation of plans for everything that is affected, and it should include a review of the planning method. At the end of the planning phase—or often during it—a formal decision is taken by management to approve the plan and release it for implementation.

The implementation or **execution phase** also involves three steps. Fundamental questions (should) have already been answered during operational planning, such as which production factors need to be combined, when, where and how. Having been planned, the execution phase needs to be implemented and monitored. The liquidity plan is an example of a tool that can be used in this phase, because it takes the budget that was developed during the planning phase and transforms the budgeted revenues and expenditures into payment flows that can be applied to financial execution.

Similar considerations apply to the **supervision phase** which can also be divided in at least three parts. The activities involved in comparing planned and actual results must themselves also be planned, implemented and supervised. Feedback derived from the analysis of differences and their causes helps to improve planning for the next project.

Figure 9.8 shows the correlations. It needs to be borne in mind that what is shown by no means only happens in neat sequences, but that phases can run in parallel.

Details of the management process from the point of view of controllership are dealt with later in this chapter. At this point, the impression is to be avoided that management tasks can only be accomplished through these technocratic circuits. The assertion of interests and the playing out of conflicts in a political sense are also part of the management process. Individuals with different abilities, competences and levels of performance play a role in all phases. They differ in their attitude towards the company as well as in ambition or use of power. **Decision making** is often a difficult undertaking, associated with insecurity, uncertainty and unknowns, not immune to departmental egotism, manipulation and insider relationships. Frequently it is not just one single decision—even if it has been made formally and is a

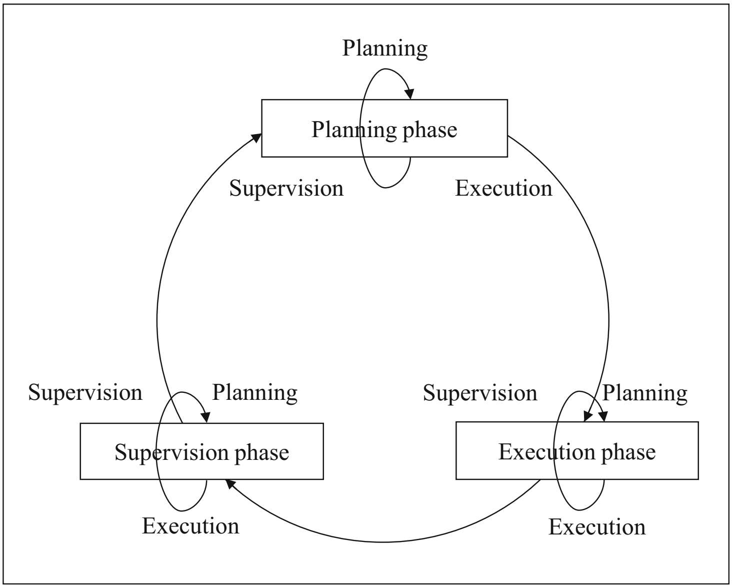


Fig. 9.8 Primary and secondary circuits in the management process

big decision—that creates new facts in the shorter or longer term, but rather a series of directives, approvals and decisions that are limited in their individual scope, but which cumulatively move the organisation in a particular direction.

9.1.5 Management Competence

Management competence is the result of acting responsibly, which means being guided by ethical and legal norms, being committed to the job and to the entire company, and being accountable. It is built on professional competence, which includes specialist knowledge and the ability to apply it, competence in methods, systemic competence, which means acting in a holistic, interdisciplinary and intercultural manner, and social competence.

Which of these various competences is of particular importance in comparison to the others depends on the characteristics of the business entity: its size, goals, location, culture and so on. It is generally safe to say that no firm can survive if its managers have neither professional nor social competences. The former means that work activities are organised correctly and the latter leads to the involvement of others. The tendency to overestimate their own capabilities and unnecessary ruthlessness are frequently observed when a manager's social competence is limited.

The capabilities of managers must include knowledge and skills. **General knowledge** is the knowledge that is acquired through general education. **Specialised knowledge** is classified according to the different disciplines—it is the knowledge of doctors, bankers, librarians, chemists, forest wardens, craftsmen, engineers, nurses, and so on. **Management knowledge** is interdisciplinary. General knowledge is the basis on which specialist and management knowledge are built. General and management knowledge present relatively few communication problems, as the vocabulary used is in common usage, but this is not the case with specialised knowledge. "Nerds" are therefore not executive material if they can only express themselves in their specialised language. In other words: a scientist who knows only about splicing DNA and has no knowledge of the labour market, co-determination, capital markets, budgeting, balance sheets or other elements of management knowledge is hardly likely to be chosen to become a senior executive even in a pharmaceutical company.

As Fig. 9.9 shows, the boundaries between the different kinds of knowledge are not cast in stone.

Knowledge on its own is insufficient in the real world; it must be complemented by skills. Gaining knowledge requires skills, as does applying knowledge; the skill of applying knowledge to practice is **know-how**. Often, only three types of skills are identified: technical, social and conceptual. However, this is too broad a categorisation, so we identify five sets of skills: intellectual, communication, technocratic, physical and psychological skills.

We place knowledge in the centre of Fig. 9.10 to show clearly that skills are grouped around knowledge, and that it is skills that produce external effects.

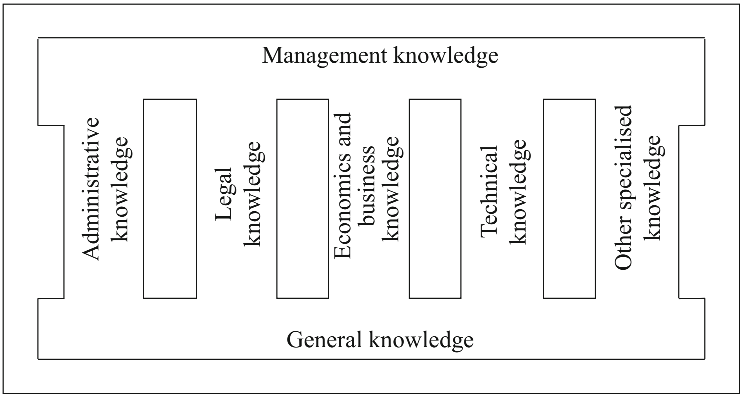


Fig. 9.9 Kinds of knowledge

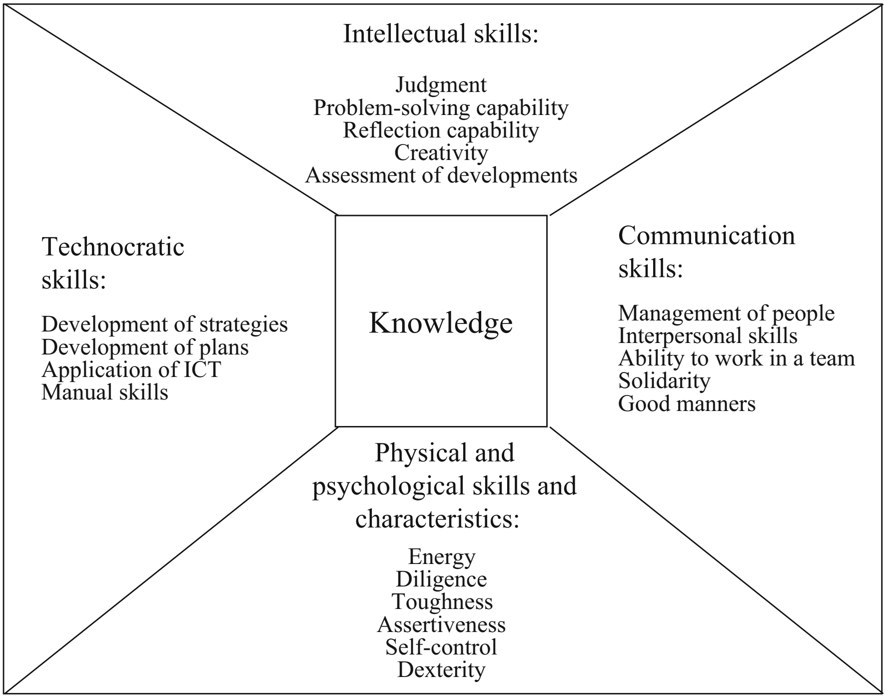


Fig. 9.10 Skills for the application of knowledge

Knowledge and skills come from aptitude and learning, but where management competences come from is less important than that they actually exist at a high enough level. Their existence is obviously an important factor in decisions made in human resource management—the performance and potential performance of an individual play an important role in selection processes, for example. Employees, in turn, need to work on weak areas. They may be informed about these in a performance evaluation, or they can take do a self-evaluation of their performance and motivation levels. They may ask themselves if their knowledge and skills (all four types) are at the level they could or should be, and if not, what can be done to remedy this. Being capable and motivated also means being willing to be led.

Competence and responsibility do not have just a personal dimension, for there are also functional and institutional dimensions. The former refers to the **area of responsibility** within which the manager makes decisions, and the latter to the **positioning** of the job in the organisation, i.e. where the job sits. Good management seeks to align individual, tasks and position. Everyone benefits if it is possible to match the goals of the individual manager or employee with the goals of management and the company. Achieving this is not easy and depends on management style, incentives and deterrents.

There have been numerous attempts to create simple and uniform **rules about management styles**. However, they are all ultimately bound to fail because everyone is different, with age, gender, ethnicity, language, national culture, personal traits and characteristics all influencing their personality and behaviours. No less heterogeneous are the tasks in a firm in its environment of market, society, state and nature. Even the positioning of managers and employees—both in the organisational structure and geographically—is not simple because the company can be organised in a centralised or decentralised way, based on functions or on markets. On top of this come job classification and remuneration with its fixed and variable elements. Given such diversity, it is really only possible to establish broad principles for a management style, dealing with broader questions like the situations in which being participative or authoritarian is appropriate. Companies that are active internationally face particular challenges for which they need managers who have intercultural skills.

Special Note The German company Siemens AG was founded in 1847. Today, it has over 350,000 employees and its revenues in 2016 were 79.64 billion €. Its path in recent years has not always been smooth, for it has been involved in numerous cases of bribery and price fixing which have led to hefty fines. The company decided to do something to change a corporate culture that made such behaviour possible. It built up its compliance organisation whose remit is to stop misconduct and one of its methods was to produce and distribute the company's Business Conduct Guidelines. The following extracts are from the latest version of the guidelines (January 2009) include:

A.2 Mutual Respect, Honesty and Integrity

> We respect the personal dignity, privacy, and personal rights of every individual. We work together with individuals of various ethnic backgrounds, cultures, religions, ages, disabilities, races, sexual identity, world view and gender. Consistent with our corporate principles and with the employment laws of numerous countries in which we work, we do not tolerate discrimination against anyone on the basis of any of these characteristics or harassment or offensive behaviour, whether sexual or otherwise personal [. . .].

A.4. Management, Responsibility and Supervision

The culture of integrity and compliance in an organization starts at the top. All managers must fulfil their duties of organization and supervision. All managers bear responsibility for all employees entrusted to them. All managers must earn respect by exemplary personal behaviour, performance, openness, and social competence. This means, among other things, that each manager must emphasize the importance of ethical conduct and compliance, make them regular topics of everyday business and promote them through personal leadership and training. Each manager must also set clear, ambitious and realistic goals and lead by example [. . .].

F.1. Environment and Technical Safety

Protecting the environment and conserving natural resources are high priorities for our Company. Through management leadership and employee commitment, Siemens strives to conduct its operations in a manner that is safe for the environment and continually improves environmental performance. A worldwide environmental management system has been implemented by Siemens to ensure observation of the law and sets high standards for this purpose. Beginning at the product development stage, environmentally compatible design, technical safety and health protection are fixed as targets.

All employees must contribute to these goals through their own behaviour.

9.1.6 Controllership

It is a truism that management systems cannot get by without information and communication technologies, but other, older, forms of support continue to be vital. These include analytical, statistical and evaluation-based methods and tools such as company and process benchmarking, cost accounting and investment appraisal, balance sheet and asset analysis. The use in German of the term *Controlling* for these activities started in the 1970s but the function (called **controllership** in English, although some firms today use *controlling*) has existed in US companies for over 100 years, and those carrying it out are **controllers** (sometimes **comptrollers**).

Controllership focuses on the procurement, analysis and distribution of information relevant to decisions that need to be made; such information is needed when management is faced with complex tasks in difficult situations requiring a lot of time and effort to coordinate. This is particularly the case in large and medium-sized companies where many employees work together on the basis of the division of labour. Executives in small companies tend to perform controllership tasks themselves, as they represent the preparatory work for the decisions the executives themselves need to take. **Strategic controllership** is concerned with fundamental goals and far-reaching decisions, and **operational controllership** deals with sub-goals and ongoing operational and tactical decisions. Top management are responsible for strategic controllership because the decisions involved concern the continuing existence of the organisation, its actual and potential performance, its structure, future directions and characteristics as an employer.

Controllers in their function as information managers have to monitor objectives and plans, to identify deviations and their causes and advise on course corrections. They carry out their activities for the factors of production, for functions and to some extent for projects and processes. It is common to set up first controllership "islands" that look at narrow topics, and that are later brought together to form a comprehensive controllership system.

External and internal **sources of information** are used to meet the demand for information. Among external sources are research reports and market analyses by consulting firms, government statistics, reports by industry associations, legislation and legal decisions, government declarations and party programmes. Internal information comes from analysis of all the different budgets, accounting reports, financial analyses and various performance data that a company has.

There is some discussion about where controllership as a function and the employees assigned to the activity should sit in the organisation structure. On the assumption that the goal of controllership is to provide management support, controllers should have access to the decision-makers but not be decision-makers themselves. Controllers can be found in line functions as part of the chain of command as well as in staff functions, where they are independent of the line organisation. When there is more than one controller, they are either integrated in a single controllership department which interfaces with the rest of the organisation, or they are placed in decentralised specialised organisational units (e.g. in profit centres).

Controllership is a complement to the management process, not a substitute for it. Planning, execution and supervision remain the basic tools of managers; the results of controllers' activities are a form of counter-check to what the managers are doing. If the management process is understood as a **circuit**, controllership represents a **dialogue** with its individual phases, forcing management to deal with additional favourable—or unfavourable—data and facts prior to taking decisions. In this respect, controllers are managers' economic long-term opponents who are aiming to reach their own goals.

Figure 9.11 illustrates the role of controllership.

The following sections deal with the correlations indicated by the three bold arrows. **Controllership serves to provide planning, execution and supervision with the sound basis a successful corporate policy needs**.

9.2 Planning

9.2.1 Strategies

Planning is the theoretical anticipation of future events. It is a deliberate and systematic activity, not an improvised one, carried out within the framework of analyses of economic efficiency and effectiveness. Business entities plan in order to

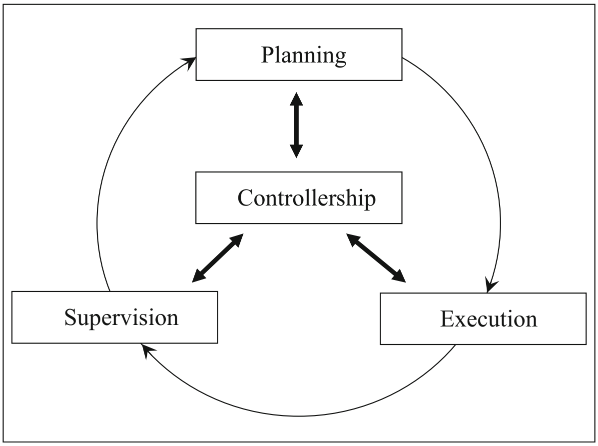


Fig. 9.11 Controllership in the management process

achieve stability, which leads to longevity, and flexibility, which leads to adaptability; they then have a solid base on which to build. Together with setting goals, establishing a strategy is the most important task of planning. The term *strategy* was originally used by the military. In his main work, "On War", Carl von Clausewitz (1780–1831) defines strategy as being about winning a war, and he considers tactics as being about winning a battle. Based on this differentiation, we can then say that strategic planning, strategic management and strategic behaviour are concerned with fundamental issues and the long term.

A company's strategic direction usually follows one of three kinds of **basic strategy** (see Fig. 9.12). A firm using the cost leadership strategy seeks to gain a considerable cost advantage compared to competitors, and this requires large outputs and a lean cost structure. The differentiation strategy aims at positioning products favourably against competing offers with respect to quality, design, image and service. The niche strategy is defined by a concentration on the demands of one market segment, and is of particular interest for small companies.

Firms need a conceptual framework that allows managers to choose strategies for future growth. Four types of strategy have emerged (see Fig. 9.13):

- the market penetration strategy involves trying to increase the market share of existing products on existing markets,
- the market development strategy means that existing products are sold in new markets, while
- selling new products in existing markets is the basis of the product development strategy, and
- diversification involves offering new products in new markets.

These strategy types are often combined in practice.

Little research has been done about the strategies of non-profit organisations or types of business entity other than firms. The research that has been done on how they see future developments suggests that the medium and short term dominate. Operational

Fig. 9.12 Basic strategies

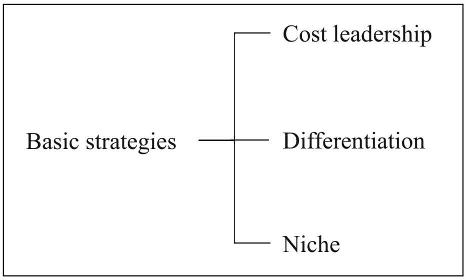
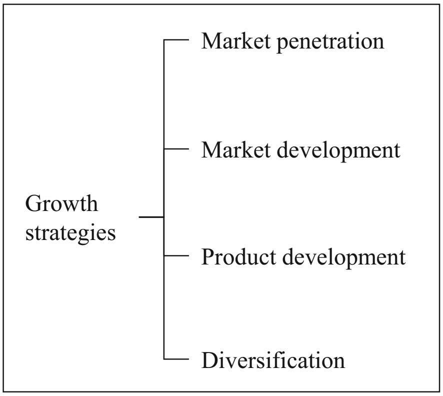


Fig. 9.13 Growth strategies



considerations determine actions: uncertainty about income, payments that need to be made in the near future, the fixed bureaucracy and the election cycle are uppermost in thoughts of private households, associations, professional chambers and church, municipal, state and government administrations.

Strategic planning starts with an assessment of the **current position**, with the goal of identifying the opportunities and threats in the environment of the company and its own strengths and weaknesses. The **company environment** is more than just the markets where sales are made and goods and services are bought; it includes society, the state and natural environment. Society—the local population and the general public—is aware of what organisations do, through opinion leaders, parties, the media and academia, and either accepts or criticises it. The state is not just the national government, but also the European Union, regional and municipal governments; all play a significant role through the legal frameworks they create, and their economic policies. The prevailing political climate plays a role that should not be underestimated. The natural environment is also significant; it is affected through the location choices made about organisational activities and it is the source of raw materials and the recipient of waste materials and pollutants.

A **PESTLE analysis** is a tool for examining these external factors:

- **P**olitical factors, e.g. government regulations, tax policies, political stability, trade regulations
- **E**conomic factors, e.g. economic growth, exchange rate, inflation, interest rates
- **S**ocio-cultural factors, e.g. demographics, education levels, attitudes, trends
- **T**echnological factors, e.g. state of technology, infrastructure
- **L**egal factors, e.g. laws related to intellectual property and employment
- **E**nvironmental factors, e.g. the ecological effect of a coal-mine.

The external environment is one starting point for strategic considerations because, while it cannot be influenced by management, it provides many possibilities for companies—as long as they have the right strategy. The other starting point is an **internal assessment.** Managers have a much higher degree of control over what happens inside the company and are able to adapt and make changes. Tools for an internal assessment have been discussed in previous chapters.

The controllership department has the responsibility of supplying the information on these external and internal factors which must be taken into account when deciding on a strategy. A number of tools are available of which the best known is the **SWOT analysis** (strengths-weaknesses-opportunities-threats—see Fig. 9.14) which should ideally use quantitative data to identify and prioritise challenges. Those responsible for strategic planning evaluate the state of affairs, using as a starting point the degree of success of the various programmes and products, processes and structures, always compared to the resources used. The outcomes

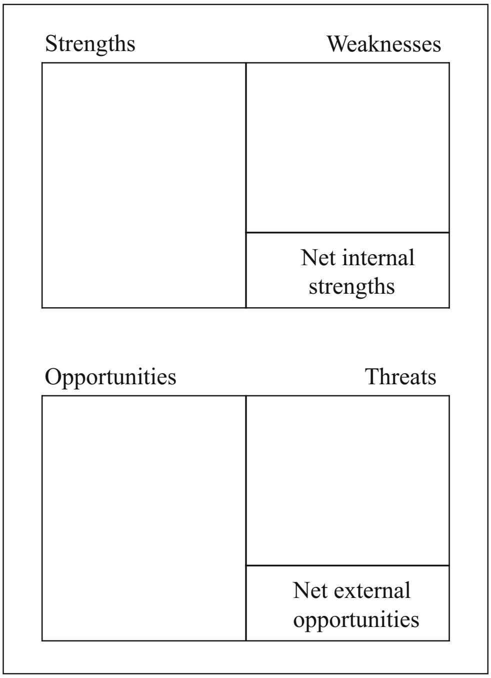


Fig. 9.14 SWOT analysis

of the planning process will include a variety of elements, e.g. some parts of a firm may be expanded, others cut back, or there could be a total restructuring, all of these options will of course be reflected in the appropriate budgets. The elements need to be prioritised and then integrated into an overall strategy.

The **strengths** of a company can include an attractive portfolio of products and services, stable market share and turnover, a strong brand, a knowledgeable workforce, a high standard of research and development, good labour relations, modern fixed assets, sufficient capital for expansion. A company can show **weaknesses** in these same areas. Other weaknesses can include poor marketing and sales, group structure, an insufficient use of synergies, executives playing it safe, below average profitability, a large percentage of the turnover coming from very few customers. The opposite of these weaknesses are of course strengths.

Opportunities for a firm may be changes in consumer behaviour, the removal of restrictions in world trade, structural reform in a market that is relevant for the firm (for instance, healthcare deregulation), improvement of infrastructure and logistics, the development of new markets (for instance, online services), shakeouts in the market and a large well-qualified labour force. **Threats** include intensified competition, innovative competitors, increased cost pressure, shortage of capital, abolition of public subsidies, declining prices for products, bureaucratic restraints (for example, long-winded approval procedures), new legal bans or requirements, media criticism, risk of law suits.

An **opportunity analysis** is used to determine where a company might find success. The strengths of the company are compared to those of the most important competitors and the critical success factors of the market. The analysis focuses on how the factors can be managed in order to be more successful. Customer surveys are a useful tool for this kind of analysis, as they can provide information about which problems customers would like to see solved.

A **portfolio analysis** is a collaborative effort between strategy development and controllership. The usual method is to construct a matrix as seen in Fig. 9.15, which shows the Boston Consulting Group model. The position to which products and services are allocated should be based on numbers, of course. This analysis is used

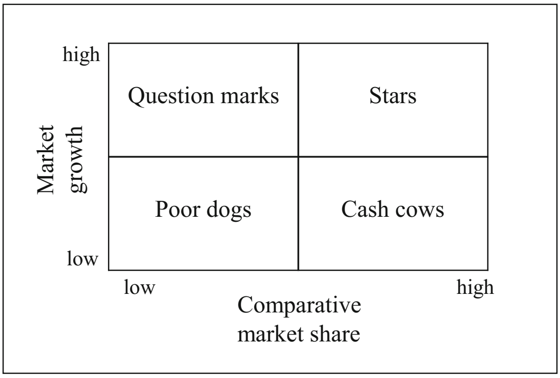


Fig. 9.15 Portfolio analysis matrix

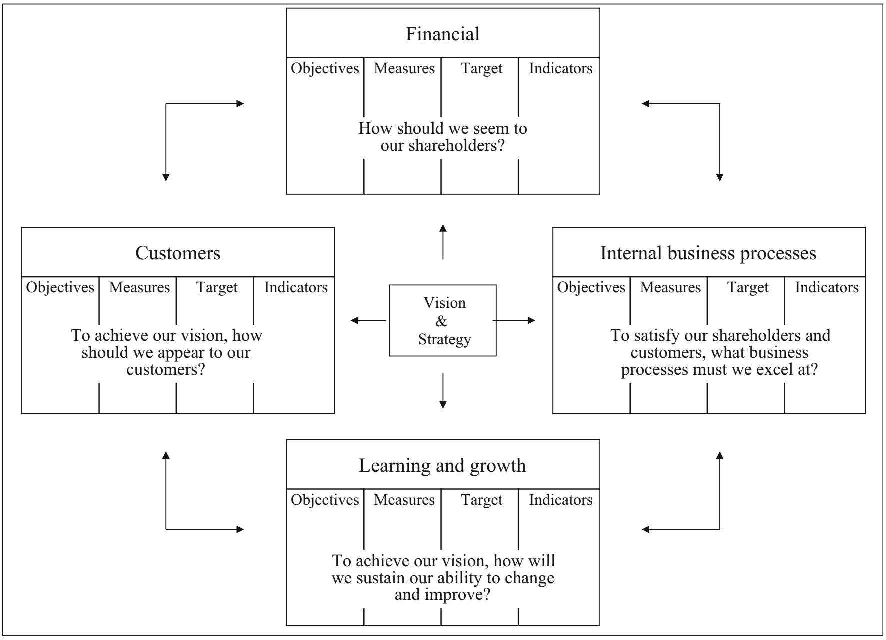


Fig. 9.16 Balanced scorecard

to help decide where resources should be put so the company can take advantage of its competitive advantages.

A **value chain analysis** investigates the creation of value in each process step and relates this to costs and potential for differentiation; suggestions for rationalisation, insourcing and outsourcing may be the result.

Inter-company and intra-company comparisons are very valuable—provided that access to facts and data is possible. Comparisons can be made in many areas, including products, processes, financial ratios, marketing campaigns and so on. The aim is to find out whether a company is above or below average in the given area. In the special case of **benchmarking** the aim to identify the best in class and then copy and adapt what the best company does.

A popular tool is Robert S. Kaplan (b. 1940) and David P. Norton's (b. 1941) **Balanced Scorecard (BSC)** which tries to overcome the common focus on finance-oriented business ratios by establishing a balanced mix of monetary and non-monetary information in a scorecard that maps the critical success factors to four perspectives: financial, customers, internal business processes, and learning and growth [Fig. 9.16—based on Kaplan and Norton (1996)]. The company vision and strategic targets are the starting point. The latter are quantified and goals for each company division are set top-down, after which the next step is taking action. The manager responsible for any given task is given a target expressed as a percentage; typical examples are a reduction in personnel costs, increase in sales to a particular customer, the speeding up internal business processes and raising employee potential by means of further training.

The Balanced Scorecard can also be applied to non-profit enterprises by expanding the financial perspective to include substantive goals, by adding stakeholders to the customers section, by paying more attention to services in the business process section and by viewing the qualification and motivation of the full-time, part-time and voluntary staff as the main factor for increasing performance potential in the learning and growth section.

The **scenario planning technique** is used for generating alternatives of what the future may look like. Usually the outcome of a series of workshop, various possibilities for the future are established and ways of dealing with best case, unchanged and worst case situations are developed.

9.2.2 Operational Planning

Operational planning is usually done for a period of 1–5 years; it can be understood as the element between strategic planning and short-term planning (that mostly deals with time spans of under 1 year). It involves the generation of plans that use quantitative data, and ideally also monetary units, for the medium term. Operational plans are developed for **goals** (e.g. profit and loss, reorganisation, redundancies, acquisitions, liquidation), **institutions** (e.g. group, branch, profit centre, department), **factors** (e.g. financing, staff positions, material plan), **functions** (e.g. sales, production, purchasing, waste disposal, research) and **processes** (e.g. work scheduling, inspections).

Operational plans serve to make strategies real in two respects, for they have **an informational** and an **instrumental** role. They contribute information to strategy development and once the strategy is established they implement it. In this respect, they fulfil. Where operational planning is used **to support the development of strategies**, the controller checks if and to what extent the plans are aligned to the potential strategic focus of the company as a whole. The controller must watch for possible departmental self-interest, isolated planning approaches, over-optimistic expectations, and planning and calculation mistakes. Controllers themselves are not infallible so they must be particularly vigilant about their own efforts when themselves developing operational plans. Unlike strategic controllership, operational controllership's goal is to ensure that operational plans are appropriate for the organisation's **strategy implementation**.

As discussed in Chap. 7, a number of different **controllership tools** are deployed during operational planning processes; these are methods used to collect, structure, analyse, store and forward information.

Earnings planning using financial ratios provides a good example of the role controllers can play. The starting point is how the business developed over the

Years / Ratios	2016		2017					2018	2019
	plan	actual	plan	actual				plan	plan
				I.	II.	III.	IV.		
Sales revenues									
Other income									
Operating expenses									
Annual surplus									
Return on sales									
Return on equity									
Cash flow									
Free cash flow									
Investment ratio									
Sales productivity									

$$\text{Return on sales} = \frac{\text{Annual surplus}}{\text{Sales revenues}} \cdot 100$$

$$\text{Investment ratio} = \frac{\text{Investments}}{\text{Sales revenues}} \cdot 100$$

$$\text{Return on equity} = \frac{\text{Annual surplus}}{\text{Equity}} \cdot 100$$

$$\text{Sales productivity} = \frac{\text{Sales revenues}}{\text{Employees}}$$

Cash flow = Annual surplus + Depreciation

Free cash flow = Cash flow – Investments

Fig. 9.17 Earnings planning

previous period, then the planned results of the current year are compared to the actual quarterly results. This then provides a basis for planning future results, as illustrated in Fig. 9.17, which also shows some key financial ratios.

The various fields contain forecast values which are developed from the desired strategy; they are based on certain assumptions and depend on the firm's activities and market expectations. Income growth can be achieved by concentrating on the core business, by building up secondary businesses or diversification, which may require investment in new assets, in expansion or in replacement investments—these affect the investment ratio. Rationalisation and economies of scale and scope can contribute to lower expenses, while increased marketing and sales efforts may lead to better operating results, as may innovation goals such as that new products should bring about a 10% increase in turnover every year. Financial ratios sometimes conceal quality improvements of products that are the result of employee training, or improvements in factor combination which have a positive effect on productivity.

Description of company	Corporate purpose Legal form Share capital Owners Registered office Locations
Production programme	Products Brands Rights Patents Contracts Employees
Valuation	Book value Net asset value Earnings value Replacement cost value Liquidation value Purchase price
Strategic fit	Synergy effects Revenue growth Revenue potential Profit growth Market share growth Improved image
Post-merger integration	New structure through merger or cooperating network? Composition of corporate bodies Reorganisation of activities Centralisation or decentralisation of production and sales? Integration into new product lines (manufacturers) and new ranges (dealers)
Financing	Equity and/or debt financing Security (sureties and guarantees) Terms of payment

Fig. 9.18 Components of an acquisition plan

An **acquisition project** is a second example of where operational planning is carried out. The work could be done by a business development staff unit or by a team of controllers before the plan is submitted to top management board.

Figure 9.18 shows the information included in an acquisition plan.

9.2.3 Budgeting

Strategic and operational plans are usually implemented via budgets. Budgets are short-term (up to one year) plans that require a certain level of commitment; the amounts in them are tied to specific purposes. Budgeting, i.e. the process of **creating a budget**, is usually part of operational controllership. In the narrow sense, budgeting ends with the **approval of the budget** and **the passing of budget responsibility** to the appropriate departments or individuals. In a broader sense, the activity of budgeting also includes the **implementation and supervision of a budget**, including the analysis of variances as well as any necessary **budget modifications**.

Budgets can be classified according to a number of characteristics. Classifying by **purpose** enables us to identify purchasing, production, research and development, sales, personnel and project budgets, etc.; using **volume** as a criterion means a distinction can be made between overall and partial budgets, global and detail budgets, group, company, department and branch budgets; the **period of validity** allows a differentiation between weekly, monthly, quarterly and yearly budgets, while the **value dimension** distinguishes between expenditure, cost, contribution margin and turnover budgets. Examples of budgets that one would find in a company are the yearly budget for the public relations department, the quarterly budget for sales revenues and the monthly budget for a production cost centre.

When working out a budget, care should be taken that the figures correspond with those that have been decided at a higher level and that individual budgets, although managed in isolation, are coordinated with each other. This is made possible by a **budget system** that brings together individual budgets (such as those of business units, subsidiaries, profit centre employees, domestic and foreign investments) into a single comprehensive budget. In groups of affiliated companies, a multi-level structure is used, where the units at the base (e.g. subsidiary limited companies) belong to a division or intermediate holding, which in turn represent investments that the holding at the top of the hierarchy of companies has made.

When each company has its own budget, as is generally the case, the budget system of such a multi-level group looks like that shown in Fig. 9.19 [where *AG* means Aktiengesellschaft (stock company, i.e. one that issues shares) and *GmbH* means Gesellschaft mit beschränkter Haftung (limited liability company)].

The short-term focus of the financial framework (up to a year) means that budgets are the most important operational control tool between and within group companies—this is of course true for all kinds of companies, from the smallest and newest to the largest and oldest. It is of vital importance that budgets are linked with responsibilities for resources and results, as well as with incentives and sanctions. **Budget execution** requires first of all that the budget be guaranteed, secondly that there is a degree of flexibility in how and when budgetary resources are used, third, that there is an immediate reaction to positive and negative changes regarding the budget, and finally that success is rewarded in the form of bonuses.

Budgeting can really only start after difficult and complex decisions have been made about goals and strategies, and after other requirements and expectations have

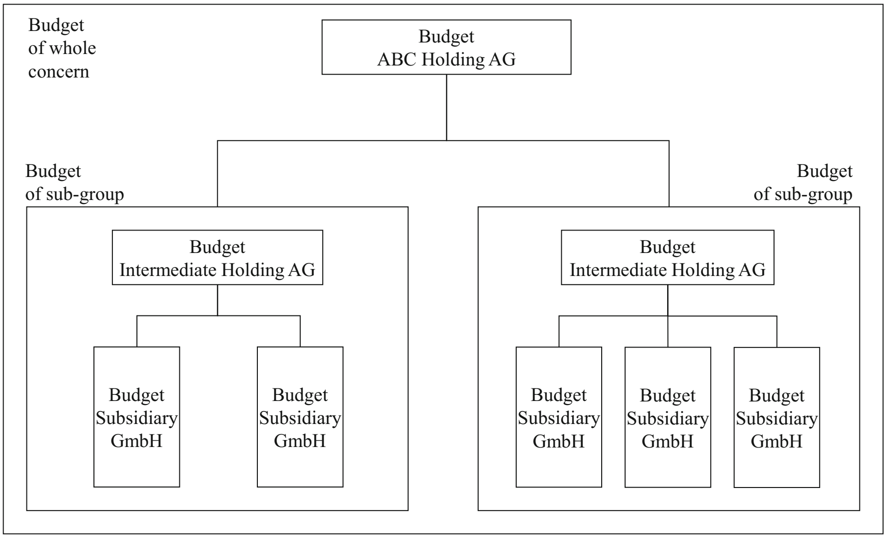


Fig. 9.19 Budget system of a multi-level concern

been made laid out. Sometimes departments struggle to get benchmark figures for operational resources and market potential, and occasionally estimates (e.g. sales of a new product) must be tested in pilot projects before releasing to the wider market. At the same time budgets can and should play a role in the balancing of interests within a company, the motivating of executives and employees, encouraging economic efficiency, opening up possibilities for more effective controllership activities. In general budgets are vital to a company's survival.

9.3 Execution

9.3.1 Organisational Structure

Execution follows planning in the management process. It is more than merely realising intentions; it is the goal oriented implementation of concrete concepts within a framework that is essentially set by the organisational structure, personnel and finances. Behind all this lie a huge number of individual discussions, decisions and actions that take place in the different parts of the business entity, such as implementing change in business divisions, making use of properties, deploying technology, arguments between top managers, talent management, going public, taking steps to assure liquidity and so on.

The importance of the organisational structure in turning plans into reality cannot be overstated, because it allows the institutionalisation of relationships between the production factors. One of the first to identify the essential elements of organisational structures was Erich Kosiol (1899–1990). The starting point is **task**

analysis, which examines what is actually happening in the organisation—what kind of work is being done? Mental and/or physical? Giving instructions or executing them? The analysis also looks at tangible and intangible assets and financial resources. Tasks are broken down into their individual elements and their interdependencies are established, always taking into consideration the time and space required to carry out the tasks.

After the tasks that have been deconstructed by task analysis, **task synthesis** combines the task elements on the basis of the division of labour into jobs. A decision has to be made as to whether or not machines or people will carry out the jobs, which naturally requires a great deal of thought. If people are to do the jobs, a job description is prepared, which is not linked to individuals but describes the tasks associated with the job. The compensation for the job must be established and then someone has to be recruited and selected. Recruitment involves finding qualified candidates and selection processes use various kinds of test to ensure that the chosen candidate has the competences and skills needed to perform the tasks.

The **competences and responsibilities** of the person who holds the job are defined; these include the authority to make decisions, to give instructions, to commit someone to something, to dispose of something or to pass on information. In public administrations superiors have the right to take over a task from someone else if they think it is necessary; they also have the right to supervise, to overturn decisions that have been made by superior authorities, the right to be heard, to make suggestions, to consent, to approve, to coordinate and to sanction. There are also attendant obligations, such as to give instructions, to comply, to inform, to report, to supervise, to consent, to obtain permission, to desist, to perform, to coordinate, to account for past actions.

Three different **degrees of participation** are to be found in coordination processes: communication (notification, briefing), consulting, and co-decision making (agreement, approval). This can be done in oral or written form.

The relation of the positions among each other depends not only on the distribution of competences and responsibilities but also on the design of the organisational structure. **Concentrating positions** is the pooling of those positions that closely cooperate while completing a task. The **creation of departments** provides a horizontal relationship between cooperating organisational areas and the **creation of management units** creates a vertical relationship. In this context, the span of control needs to be taken into consideration since it defines the number of subordinated people or organisational units.

The **line and staff unit organisation** must be designed. As discussed in Sect. 9.1.1, the principles of Henri Fayol require a hierarchical structure with a single line of authority, in which an employee receives direction from a single superior. In Taylor's system one position is subordinated to two or more positions and unity of command is replaced by the principle of the shortest distance. The staff unit organisation, which in most cases exists as an add-on to the line system, is defined by staff units, i.e. organisational units without the authority to give instructions but which have advisory, planning, preparatory and supporting roles. Figure 9.20 shows a typical organisational structure with two staff departments (HR and Legal) and four line departments.

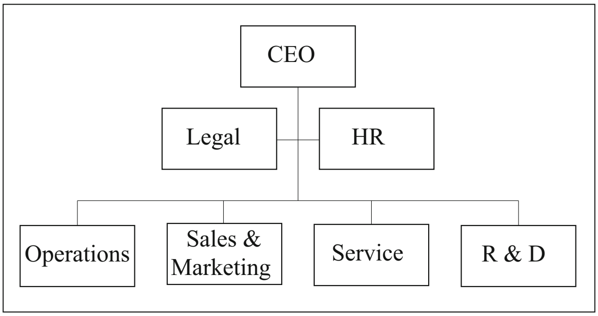


Fig. 9.20 Organisational structure

Committees of various types are established to coordinate activities and to avoid the need for constant reorganisation whenever there are new tasks and projects. Also known as working groups, advisory boards, project groups or commissions, they enable long-term cooperation between staff that are normally located in different areas and can be created for permanent tasks or specific reasons. Typical examples are a project group for the advertising campaign of a company, a committee of an industry association that is preparing a report on a particular issue, or the examination board of a Chamber of Commerce and Industry. Very rarely do they have job positions permanently attached to them, but resources will be made available to them to enable them to complete their tasks.

Centralisation and decentralisation must be distinguished from concentration of positions, which relates to functional relationships. Here the issue is about where organisational units should be physically located. The frame of reference can be a building (e.g. the accounting department should be on the fourth floor next to the financial department; the head of sales should have a corner office) or a region, country, continent or planet (the marketing department should be at headquarters in Berlin, but manufacturing should be done in China, while the software programmers should be in India).

The **organisation of top management** is a difficult issue for which there is no single solution. Participation in the decision-making process and the distribution of power are key concerns. Autocratic management is found when one person makes decisions alone, while in the case of directorial management one person decides and other members of the management team are collectively responsible—in some cases they have veto rights. Under the collegial principle several people make decisions together.

As noted above, the role of the controllership function is to support management, so it must examine the organisational structure to see if it will allow corporate objectives to be met and if it is fit for the future. The higher up in the organisation sit the people with whom the controller must deal, the more difficult the job. Controllers should involve top management in their activities; however, restructuring processes often fail because of top executives, especially those who are negatively affected by the analyses and recommendations of the controllers. The German company Bertelsmann, a large media and publishing company, for instance, has found an innovative solution to prevent blocking by individual executives. According to the rules of procedure of the management board, the head controller—although not a member—has the right to report to the management board, so she can submit suggestions to the top management and, at the same time, remain uninvolved in possible conflicts at that level.

When looking for tools that can be used for the controllership of the organisational structure, controllers have essentially to rely on insights from around the world about the optimal size of a firm, spans of control, lean management, organisational development, the benefits and problems of matrix organisational structures, profit centre concepts, and other relevant topics. In short, they have to determine what best practice is.

9.3.2 Process Management

The organisational process structure is concerned with the organisation of operational activities and as such is the companion to the organisational structure. This division into processes and structure is helpful for didactic and analytical purposes, but is limited in that structure determines processes and vice versa. At the same time, it is indeed possible to analyse individual work processes and their elements in a given organisational process structure.

Similar to task analysis, **process analysis** investigates how processes are carried out, their subject matter, the resources used, use of space and time, and their interrelationships. One popular approach is to establish the present state of business or production processes, to identify weak points and measurement criteria, to develop goals and propose a concept (business or production process analysis). Activity based costing (see Sect. 6.5.2) is carried out in parallel, this being a cost analysis of the present and proposed processes which includes identifying the main and supporting processes, cost types and cost drivers.

Whereas process analysis focuses on deconstructing processes, **process synthesis** aims at the grouping of individual process elements. Viewed at the level of personnel: process synthesis (distribution of work) allocates process steps to individual positions (division of labour) and their holders (allocation of work). Temporal process synthesis (pooling of work) tries to establish the sequence of process steps (order of operation), the intervals (coordination of timing), the work to be done during time periods (coordination of rhythm) and the adjustment of the timing of process steps (coordination of rest periods). Local process synthesis (design of work spaces) allocates process steps to specific workplaces and workstations, linking their equipment to the process steps.

The organisational process structure has the responsibility of enabling the synchronisation of process steps with the **exchange of information**. The flow of information takes place through official process channels, but also informally, as when colleagues share a table in the cafeteria or smokers stand together outside in the rain. A management information system supports preparing for decision making (controllership), regular or ad hoc reporting and the monitoring of progress.

Processes have to be reviewed with the aim of establishing if there should be **general or case-to-case** rules and regulations. General regulation means that there is a single, binding way of doing things, which can be achieved through means like procedural rules, instructions from supervisor, guidelines, timetables and schedules, and flow charts. General regulation can turn processes into routines, but the danger is that they deal with things in a mechanical way. Gutenberg's substitution law of organisation (see Sect. 1.2) states that case-by-case decision making should, if possible, be replaced by general regulation, but this law has limited applicability because special activities may not be carried out optimally if a general regulation is followed that ignores important specifics.

Process controllership consists of activities like examining procurement transactions, transport routes, work processes, product development, production processes, distribution channels, product life cycles and coming up with suggestions for improvement. These might aim at lowering costs, increasing productivity, securing and raising quality and increasing turnover. The most important methods include process comparison, competitive analysis, innovation circles, quality management measures such as training on processes and quality management manuals, as well as the sophisticated use of information technology.

Product controllership and **production controllership** are related to process controllership—all three support managers by providing targeted information for decisions that have to be made. They focus on the issues related to the coordination of those involved in processes, products and production. Questions that come up in this context include: Where can synergies be made and redundancies eliminated? How can deviations from plan be forecast better? Can processes be improved by insourcing or outsourcing? How can capacities be better used?

9.3.3 Human Resource Management

It is a commonplace that institutions exist through people, but there is more than a kern of truth in that saying. In today's knowledge society, where services generate three times more of the gross national product than manufacturing, the success of a company or government department or hospital depends ever more on skills and competencies of executives and employees. Executives make the central decisions, establish principles and goals, and make plans, but they depend on having skilful employees to implement all this and deal with customers, suppliers and other stakeholders. Human resource management therefore has a key—but sometimes underappreciated—role. Its main areas of responsibility include recruitment, selection, evaluation, training and development, and compensation. Its goals can be summarised as having the right people, in the right number, in the right place, at the right time.

Human resource (HR) policy and personnel development form the basis, on top of which come HR administration and personnel management. **HR policy** establishes the principles and must be aligned with the strategy of the business entity. **Personnel development** is mainly concerned with management development. It offers training, coaching and specially chosen job placements, and assesses

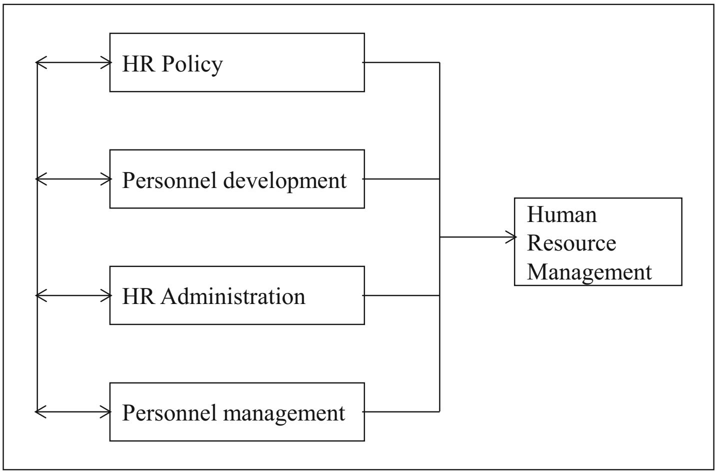


Fig. 9.21 Components of human resource management

performance and potential. **HR administration** is an administrative function whose tasks include the organisation of recruitment, looking after individual personnel files, producing statistics, dealing with the payroll, recording absences and holidays and much more. **Personnel management** is concerned with operational aspects. It involves personnel planning, where future needs are identified in terms of numbers and types of employee, job planning, job evaluation (for remuneration purposes). It also involves manpower planning which allocates employees to their positions (in offices, vehicles, on shop floors, at machines, as field sales force and abroad). Other responsibilities include identifying personnel costs and the performance evaluation process.

Although all four areas are heavily interconnected, they are shown separately in Fig. 9.21 to make clear that together they constitute Human Resource Management.

The process of filling vacancies starts with **recruitment**. During this process, HR managers need to decide whether to use internal sources of candidates (the in-house solution) or external sources—'buying-in' through private and government agencies, advertisements (online or offline) or job applications. This is followed by the **selection** of the most qualified individual. Typical questions at this stage are: Which selection tests are appropriate? Should an external assessment centre be used? Who should carry out interviews? Are probationary periods appropriate for top managers and which criteria for success should then apply?

Hiring is not only a formal act but creates a new situation for the new hire and for the existing employees. The onboarding process is the way in which new employees are introduced to their new employer, its culture and history, to their job, workplace and their colleagues. These first experiences can have long-lasting effects.

Managing and **developing** employees involves two parties—the supervisor and the employee, each of whom has a responsibility to the other. The superior is normally well advised to set goals and incentives, and supervise performance in ways that integrate and motivate employees. Only then can they identify with their supervisor and company and (hopefully) become top performers.

Career planning is a task whose importance is often underestimated. Often referred to as talent management, it is a critical success factor in organisations given the shortage of well-qualified employees in all areas of an organisation. Positions offering the chance to learn and opportunities for promotion are a significant part of successful HR management. Individuals want to boost their career options and good companies provide training and other ways of building up competences and skills.

Compensation is a significant topic. It should not be assumed however that money is the main motivating factor. Theories of motivation, such as that Frederik Herzberg (1923–2000) suggest that factors like challenging work, recognition and a feeling of achievement motivate, while pay and fringe benefits are hygiene factors which do not motivate in themselves, but can cause dissatisfaction. There are of course groups where maximising income appears to have the highest priority—many heads of global corporations, especially those in the financial sector, appear to use the amount of compensation as a measure of their individual worldwide ranking.

Pay can be divided into two categories: guaranteed pay and variable pay. The former is the fixed amount that the employee receives on a regular basis and the latter is pay that depends on one or more factors, which can include performance, time worked and results achieved. The two types can of course be combined. The level of pay has several influences—there may be legal requirements (e.g. a minimum wage), and agreements with unions include rates of pay. Variable pay can take the form of bonusses and incentives, which can be monetary rewards or (options on) shares in the company. **Non-monetary incentives** can be important for motivation—status symbols (e.g. a good parking spot) and awards (employee of the month) are examples.

Voluntary **benefits** are provided by companies for economic, ethical and/or socially motivated reasons; a precondition is usually that the company is making a profit. Examples are extra cash and non-cash benefits and services such as above-scale holiday pay and Christmas allowances, employee pension schemes that go beyond legal requirements, support for commuting, subsidised cafeterias, company childcare and sports facilities. Such benefits increase the attractiveness of the employer and contribute to a positive employer brand, which reflects how present and potential employees view the company as a place to work.

Human resource management is supported by **personnel controllership** that ensures that corporate policy goals being met, especially those that are relevant to personnel. Among the items the personnel controller checks are the extent to which HR administration, personnel development and management are meeting their goals, how analyses of demand and personnel procurement activities can be improved, and the strengths and weaknesses in personnel deployment (e.g. in shift operations, the use of resource pool employees and teleworkers, absenteeism or higher than usual employee turnover). Controllers also look at the extent to which employee complaints are justified and harm the culture of the organisation and what can and should be done about them. They analyse which indicators do not stand up to

$$\text{Personnel ratio} = \frac{\text{Personnel costs}}{\text{Total costs}}$$

$$\text{Labour productivity} = \frac{\text{Output}}{\text{Employees}}$$

$$\text{Labour utilisation} = \frac{\text{Standard employees}}{\text{Actual employees}} \cdot 100$$

The number of standard employees is based on labour agreements

$$\text{Illness ratio} = \frac{\text{Sick hours}}{\text{Working hours}} \cdot 100$$

$$\text{Staff turnover} = \frac{\text{Employees leaving}}{\text{Employees}} \cdot 100$$

$$\text{Labour utilisation productivity} = \frac{\text{Actual working hours}}{\text{Paid working hours}} \cdot 100$$

Fig. 9.22 Indicators in personnel controllership

internal or inter-company comparisons and only score below average—the first step is to establish ways in which the current situation can quickly be brought up to target, and the second step is to look for the root causes of the problems and fix them.

The indicators shown in Fig. 9.22 are typical examples of those used in personnel controllership.

9.3.4 Financial Management

The way in which a financial plan is implemented always reveals how the management of financial resources contributes to optimal financial management. Decided on at the end of the planning phase, the financial plan is the basis for expenditures and revenues as well as for investments and their financing. Financial plans can be made for short or long periods, from months to years. The shorter the period, the narrower the scope for decision-making and the more limited the room for manoeuvre. Short-term financial plans (up to a year) are also called liquidity plans because they focus on the management of financial inflows and outflows. Medium-term and long-term financial plans are more concerned with the management of expenditures and revenues related to investments. A **timeline** can be produced on which are shown the timings of recurring money and credit transactions, such as payments of salaries and wages, advance payments, rent payments, debt servicing and tax payments on the one side and on the other sales revenues, revenues from rents, credit notes and credits for accrued interest. Certain kinds of transactions allow for more flexibility in that neither the timing nor the amount are fixed, depending on any agreement, of course. How much and when to invest, lend money, dispose of assets, borrow and sometimes repay are decisions made at the discretion of the company.

Financial management means in essence taking decisions on the use of financial means to realise plans, and as such is bound by what the budget permits. Within the limits of the budget, it must always take into consideration the formal goal triad: liquidity, profitability and security. In the case of decentralised business entities like global corporations, a decision has to be made about whether they are managed as a system of divisions by one **central financial department** or by means of a concept similar to that of profit centres, i.e. **independent financial management** is permitted. The trend in recent years has been towards the division of power and of labour. Plans are drawn up centrally—with input from the periphery—and managed at the local level.

The relationship between **financial management** with its responsibilities for the planning, execution and monitoring of finance activities and **financial controllership** can take different forms in companies. In most cases financial controllership is organised as a relatively independent part of financial management, offering critical and constructive supporting services but not making any financial decisions. Two other approaches are less common. In the first, financial controllership is seen as being the core of financial management, in which case financial controllership exerts a kind of preventative control on financial transactions. The other approach makes a distinction by classifying financial management as a line activity and financial controllership as a staff unit that either reports to the management board or directly to the chief financial officer.

In general, the activities assigned to financial controllership are primarily concerned with the goal-oriented and future-oriented **management of liquidity** while taking into consideration any factors that are relevant for the organisation's outputs. A further important activity is **investment and financial analysis** because these produce benchmarks that are used during the financial decision-making process. Performing the tasks of controllership requires constant communication with relevant departments, but since all areas of a company are affected by financial issues, financial controllership runs the risk of lacking focus. It should therefore focus on cash management, asset management and debt management, paying particular attention to the risks involved in reaching corporate goals. This implies that meeting goals set for balance sheet financial ratios (e.g. working capital ratio, current ratio and others discussed in Sect. 6.6.2) is of less interest. Such historic data do serve as a basis for planning, but current information is needed for decisions in the domain of financial management.

Figure 9.23 shows some vital questions and aspects of financial controllership.

Cash Management

- Are the various business accounts linked and conciliated regarding the withdrawal and the investment of short-term funds?
- Is cash management achieving favourable debit and credit interest rates?
- Are managers provided with relevant external data (accounts, interest rates, foreign exchange rates, money market forecasts) and internal information (invoices, contract terms, tax and social security payments?)
- Are maturity analyses and forecast statements made for liquidity planning?
- Are rebates and discounts regularly monitored and adjusted?
- Do managers use currency netting to offset currency exchange costs?

Asset Management

$$\text{Asset turnover rate} = \frac{\text{Revenues}}{\text{Capital invested}}$$

Asset turnover is vital to return on capital employed (see also Section 7.1.1). The goal is to reduce debt equity to an optimum necessary to secure business operations, which – with the same turnover – increases asset turnover and therefore the return on total capital employed.

The capital invested is the sum of fixed and current assets. The goal is to have just those that are necessary. Should receivables be sold to a factor or more favourable payment terms agreed with customers? Can inventory be reduced by reducing waiting and storage times with the help of more detailed sales planning and control procedures or just-in-time deliveries? Are all fixed and financial assets required for operations or profitability?

$$\text{Return on investment} = \text{Return on sales} \cdot \text{Asset turnover}$$

$$\text{Return on sales} = \frac{\text{Profit}}{\text{Sales}} \cdot 100$$

Debt Management

This is not so much about the optimal capital structure for a given investment programme, rather the debt-equity ratio and the leverage effect with its impact on return on equity as the debt-equity ratio increases (see Section 5.3.1).

Liabilities and the possibility of restructuring with more favourable credit conditions should be examined – payment obligations and bonds, generally categorised by maturity date (≤ 1 year, 1-5 years and > 5 years), pension obligations and foreign currency liabilities. Although the amount and maturity are not clearly defined, provisions are also included.

Debt restructuring can be affected by creditors and their behaviour, the state of the economy and interest rates, company strategy and bargaining power.

Fig. 9.23 Aspects of financial controllership

9.4 Supervision

9.4.1 Checking

Planning activities set the target, the activities involved in execution determine the actual state—supervision involves comparing them. Supervision, the third phase of the management process, has two dimensions: checking[1] by those involved which

[1]The German word *Kontrolle* is difficult to translate. There is no single English word that can always be used as an equivalent; depending on the context one might use check, control, screening, supervision, verification etc.

is to a certain extent dependent, and independent auditing. 'Dependent' and 'independent' have a double meaning in this context, referring firstly to the degree of autonomy, and secondly to the relationship to the process steps. Concerning the latter, checks are dependent on processes and auditing is independent. While there is some overlap, this distinction is increasingly accepted. Checking, as the term is used today, means to look at something twice, think about something twice or recalculate something—and make comparisons, which can be done for just about everything: incidents, data, objects, size, facts, processes, and so on.

The objects and characteristics of **checking** activities can be grouped in various ways:

- Timing in relation to what is being checked: prior (preventive checks), accompanying and after.
- Object: production factors—checks on staff, capital, material and so on.
- Functions—checks on purchasing, transport, stock, production, disposal and sales.
- Intensity—formal (e.g. compliance) and material (e.g. economic efficiency).
- Level—global (e.g. trends) and detailed (e.g. liquidity).
- Accuracy—accurate (e.g. electric power consumption) and approximate (e.g. sales) are distinguished.
- Extent—complete (e.g. valuation of an entire businesses) and partial (e.g. stock); full (e.g. in cases of embezzlement) and sampling (e.g. stock-taking).
- Relationship—direct (e.g. working hours) and indirect (e.g. consistency); centralised (e.g. in a holding) and decentralised controls.
- Choice—voluntary (e.g. creditworthiness) and involuntary (e.g. supervision).
- Notice—planned (e.g. monthly turnover) and unannounced (e.g. cash balance).
- Activity—coordination or recording.
- Objective—legality, correctness, economic efficiency and effectiveness.
- Accomplishment—task completion, target, performance, product, quality, output, outcome and impact.

Timing is a criterion that itself has a whole range of possibilities which include:

- Term—short-term (e.g. accounts), monthly (e.g. stocks), 1-year (e.g. issuing of invoices), ongoing (e.g. investments) and long-term controls (e.g. growth).
- Periodicity—irregular (e.g. giving a loan) and regular (e.g. number of staff sick); continuous (e.g. working hours) and occasional.
- Recurrence—one-time (e.g. acceptance of construction work) and ongoing (e.g. payment documents).
- Sequence—step-by-step (e.g., process steps) and simultaneous (e.g. laboratory test).

Ultimately, most checks are concerned with structure, processes, resources and results. They look for deviations, sources of error and weak spots in order to eliminate them or at least to reduce their effect. The **costs of checking** are an important consideration, because they need to be lower than the savings they generate (e.g. as a result of process improvements) or they must lead to benefits that are greater. Costs are influenced by how the checks are organised, the methods used, their extent and their frequency.

Entrepreneurial activities are activities that are checked, so checks are ubiquitous and crucial, as they help the organisation in its pursuit of strategic goals as discussed in Sect. 9.1.2. The checks on these goals require the use of two methods: monitoring and reporting. The basic question is: are goals being met? Senior management must be informed about deviations and their causes, corrective measures initiated and, if necessary, plans revised.

Checking can be done successfully if these **six principles** are followed:

- The separation of functions is the most important principle.
- Staff members must be given the authority to carry out checks.
- Checks must be targeted and objective, and try to avoid provoking resistance.
- Staff who are subject to checks need to be heard.
- Reports should be succinct and to the point.
- The costs of checking must be compared and contrasted to its benefits.

Monitoring the goal system means permanently keeping an eye on crucial business indicators and processes in order to detect unexpected developments as early as possible. Crucial business indicators and processes are those which significantly influence the overall goals, such as decreasing turnover and increasing costs, delivery failure and business interruptions (because of fire, other accidents, strikes) but also bad investments and the need to pay back taxes. To give an example: a large construction project carries risks that can only be made managed though exhaustive checking. Does cost planning for the work of the tradesmen employed match the invoices issued? Are due dates, quantities and the agreed quality being kept to at the construction site? Where, when and why are additional claims arising and for how much? Are the estimated follow-up costs and follow-up investments accurate, or will they increase? Will additional costs become apparent when the building is handed over? Can warranty claims be secured?

Senior management needs to be informed—at least given the highlights—about the answers to such questions. Furthermore, company departments must also be informed about issues that concern them so that they can take appropriate actions. **Reporting** to the management board needs to be concise. Indicators reduce complexity; comparative figures show relative changes; scales show levels of achievement; bar and pie charts make reading easier, as do graphs and other forms of illustration. The reports very frequently use the metaphor of a traffic light, where a green light means things are progressing as planned, yellow indicates that there is a deviation of (for example) 10% from what was planned and that actions need to be taken. A red light shows that there are large deviations which call for urgent counter measures.

If checking becomes a routine activity, it can lose its effect. Counterchecks, i.e. checking the checks, is carried out as part of **controllership** and can prevent this happening. Questions are asked about the checking that is being carried out to discover if, and to which extent, it is contributing to the achievement of goals.

9.4.2 Auditing

Auditing—or verification—is mostly carried out by people independent from the activities and processes being audited. Internal audits, year-end audits carried out by chartered accountants and the supervision of the management board of a German company by its supervisory board are typical examples. Other examples are the special audits that are carried out when limited liability companies are started, merge and change their legal structure; tax, embezzlement and insolvency audits; environmental impact assessments; audits by regulatory and legal agencies.

The people carrying out the **auditing tasks** produce written statements and audit reports that generally come to conclusions on the correctness of records and valuations and the legality of activities. In contrast, questions of economic efficiency and effectiveness are rarely dealt with, because they lie more in the domain of non-accountant consultants, although auditing and consulting sometimes form part of a whole package that large international firms of accountants can offer to their clients.

An **internal audit** is an example of an internal verification process. Staff members, acting on behalf of top management, independently audit internal processes, in particular those related to financing, business accounting and information technology, but organisational structures and other areas of operation can also be investigated. The main tasks of internal audits are the critical analysis and evaluation of directives, processes, and internal control and reporting systems. Internal auditors also verify the effectiveness of measures taken to prevent the loss of assets. Internal audits mainly have a preventative effect because internal auditors' work consists primarily of looking at documents. The effects of internal audits partly overlap with those of controllership, but controllership places less emphasis on the past and more on the future, but it does use the results of internal audits as an input.

Year-end auditing is the most exhaustive and most developed external verification. It examines the financial statements of companies listed on the stock market (but also private ones) for accuracy; only rarely are findings made about economic efficiency and effectiveness. It is therefore not surprising that auditing emphasises standards and techniques, the latter divided into audit planning, methods and procedures. In contrast, **audits of economic efficiency** focus on the characteristics of the principle of economic efficiency (as outlined in previous chapters), goals, the combination of factors of production; non-financial aspects may be mentioned and recorded in social or ecological balance sheets.

The high degree of **complexity in auditing** becomes apparent when looking at the example of the same multi-level corporation seen in Sect. 9.2.3. The auditing process takes a similar form to the budget process; it is adapted to the group structure and complies with commercial law, while at the same time it must take

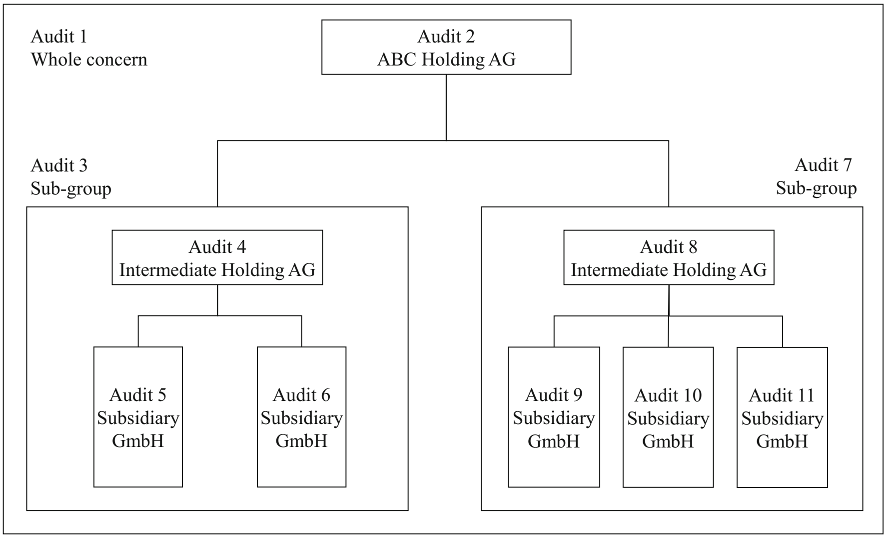


Fig. 9.24 Year-end auditing in a multi-level concern

into consideration the principles defined by the professional bodies of chartered accountants. The audit includes:

1. the management report and the consolidated accounts (group balance sheet, group income statement and group annexe) for the whole concern,
2. the management report and annual financial statements (balance sheet, income statement and annexe) of the parent company of the group,
3. the group management report and the consolidated accounts of each subgroup,
4. the management report and annual financial statements of each intermediate holding, and
5. the management report and annual financial statements of each affiliated company.

The group structure shown in Fig. 9.24 means 11 audits and audit reports.

The audit reports of the **whole concern** and the **sub–groups** reflect the management reports of the management board of the group's parent company and the intermediate holdings. They include key data such as profit for the year, equity capital, balance sheet totals and liquid funds including bonds as well as, in a summarised form, information on business purpose, lines of businesses, turnover, number of employees, possible risks concerning orders and profitability of the group companies. The auditors comment on all of this. The audit reports for the whole concern and for the sub-groups include evaluations of other statements and documents related to the group, the internal control system, and the consolidation basis. The reports judge if the consolidated financial statements were prepared for all the various management boards in the concern according to the appropriate standards. The paramount goal is to determine if there have been any changes in the bases used for valuation that might have an impact on the balance sheet elements and profitability of the whole concern and sub-groups.

The audit reports for the **individual subsidiary companies** follow a similar pattern. First of all, they contain the key data that have been submitted by management, and information on the development of business along with an assessment by the external auditor. The annual audit deals with the firm's book-keeping, the annual financial statements as signed-off by top management and the company management report. Attention is also paid to internal control systems for invoicing, fixed assets, receivables and liabilities, provisions, sales revenues and personnel expenses.

The audit reports finish after a brief description of size and content of the audit with an **auditor's statement** to the effect that the annual financial statements are accurate and complete in their representation of the financial and assets situation and the profitability of the company—assuming that no reasons have been found not to make such a statement.

The management reports, balance sheets and income statements that were submitted by the management board and managements of the different companies appear as **annexes in the audit reports** and are usually produced by financial management together with financial controllership management.

In two-tier governance systems, the **supervisory board** representing the owners reviews the management report and the annual financial statement that was audited by the external auditor. The sequence of monitoring and reporting that is followed in the checking process is turned round here: first, the management board reports on the situation of the company and submits the annual financial statement plus annex, which are then reviewed by the external auditor who summarises the results of the review in an audit report. This report is then submitted to the supervisory board for review. The supervisory board in turn reports in writing on the results of its review and of that of the annual auditor to the annual general meeting. Thus, a chain of **reporting** and **monitoring** is created, whose rhythm is different to that of checking processes. In the case of the latter, monitoring and reporting is a permanent and continuous process, the external statutory audit of accounting (i.e. the annual financial statements and management report) follows a one-year cycle. The two patterns are as follows:

Checking: Monitoring → Reporting
Auditing: Reporting → Monitoring

The verification activities of the supervisory board go by far beyond annual external audits for they include the auditing of plans, developments, construction projects, company founding, mergers, liquidations, personnel matters, and so on. Methods used include information gathering, producing statements, making decisions, approving, and appointing and dismissing senior managers. A comparison of planned and actual results is usually made and possible reactions to the strategies employed by the firm are also discussed. The preparation of such validation activities is done by strategic controllership, which provides its results to the management board which then integrates them in its submissions to the supervisory board.

9.4.3 Feedback

Feedback is the final element in the management process and closes the circuit. Feedback between supervision and planning turns the process into a control loop. When deviations exist between planned and actual results—this applies to goals as well as the strategic and operational measures that were decided on—the causes must be discovered. Are there internal or external reasons? Could advantage have been taken of them or could they have been avoided if they had been detected earlier? To whom or what are business successes owed? Who or what is responsible for poor decisions?

The **analysis and evaluation of deviations and their causes** provide inputs into planning activities. Two basic cases can be identified. In one case, the actual situation is data that cannot be changed—only new plans can achieve anything: this is feedback. In the other case, the actual situation to be analysed still allows for immediate corrections, without going through a planning phase: this is feedforward. Positive feedback indicates that the management process is optimal, while negative feedback shows a need for better plans and decisions. Systems theory, in particular the theory of system dynamics, models feedback mathematically. Applied cybernetics takes up this interactive system and tries to develop control loops that control themselves.

Due to the very high degree of complexity of business entities, economic efficiency and effectiveness can in practice only be optimised in small sub-systems, where results will in any case not be ideal. Theory is important but practical experience is indispensable for developing and implementing a holistic approach to the principle of economic efficiency and effectiveness.

9.5 Examples and Exercises

9.5.1 Microsoft's Mission Statements

Mission statements are supposed to capture what a business entity is all about. They play a significant role when strategies are being decided and are part of the framework within which employees act on a daily basis.

Situation

Microsoft's first mission statement said the company's mission was to put "a computer on every desk and in every home." This was seen by Microsoft executives to be too limiting. Under its then CEO, Steve Ballmer, the mission statement of Microsoft in 2013 became "to create a family of devices and services for individuals and businesses that empower people around the globe at home, at work and on the go, for the activities they value most."[2]

[2] https://www.microsoft.com/investor/reports/ar13/shareholder-letter/index.html, accessed 17.09.2017.

This change reflected the growing importance of the connectivity and the accompanying growth in the use of mobile devices. The statements shows that Microsoft wanted to be both the business and the consumer market, and produce both software and hardware and software, but not just software in the form of programs, but also in the form of services like cloud computing. The danger of such a mission statement is that it might mean that the company is trying to do everything for everybody.

Solution

Microsoft now says on its website, "Our mission is to empower every person and every organization on the planet to achieve more."[3] In June 2015 new CEO Satya Nadella sent an email to all employees which went into details about what this means in practice.

The 1500 word long mail says, "We must always ground our mission in both the world in which we live and the future we strive to create. Today, we live in a mobile-first, cloud-first world, and the transformation we are driving across our businesses is designed to enable Microsoft and our customers to thrive in this world."[4]

He describes the relationship between mission and strategy by stating:

"We will realize our mission and strategy by investing in three interconnected and bold ambitions.

1. Reinvent productivity and business processes
2. Build the intelligent cloud platform
3. Create more personal computing"

Activity

Look for other mission statements. What is the difference between a good and bad mission statement? Do as many German companies have them as American companies?

9.5.2 The Balanced Scorecard

The Balanced Scorecard is a system that business entities of all kinds can use for their strategic planning and management.

[3] https://www.microsoft.com/en-us/about, accessed 17.09.2017.

[4] The mail was obtained by a journalist. https://www.geekwire.com/2015/exclusive-satya-nadella-reveals-microsofts-new-mission-statement-sees-more-tough-choices-ahead/, accessed 17.09.2017.

Situation

The council of a medium size town in the north-west of England is facing some challenges. The central government has been cutting back funding, yet the demands on the services that the council provides have been growing. There were concerns that the objectives of the council were not being adequately communicated to staff, so that there was confusion in the minds of many employees about how their activities related to the council's overall goals.

Solution

Given the challenges they were facing, the mayor and chief executive decided that the Balanced Scorecard would be a very useful tool to align strategy with the activities of the employees, providing indicators that could be used to track progress. They put together a small team to prepare the implementation of the Balanced Scorecard.

The team decided that its priority was to identify the objectives of each of the perspectives. The results of their deliberations are found in the following table.

Perspective	Objective	Measure
Learning and growth	Improve quality of staff	Provide training so that staff possess the required knowledge, skills and competences
	Improve staff motivation	More and better communication Change compensation plan
Internal business processes	Improve technology capabilities	Invest in more up-to-date software and infrastructure
	Improve service delivery	Carry out a thorough review of all relevant processes and take action based on the results Expand quality management department
	Get local residents more involved	Establish some committees with members drawn from the council and the public Improve web site and become more active in social media
Financial	Reduce costs	Carry out an internal audit Introduce zero-based budgeting
	Improve financial management	Make costs more visible through improved reporting system Hire additional person for finance department
Customer	Improve programme outcomes	Outcome of improved business processes

The establishment of the objectives and measures means that it will a relatively straightforward process to develop the appropriate targets and indicators. Once this has been done, what is important will become clearer to each staff member, as will the reasons why it is important. The staff members will know what their targets are, and these could be linked to their compensation.

9.5.3 SWOT Analysis and Strategy

The great majority of business entities use a SWOT analysis as a basic tool for the development of strategy.

Situation

Fröse Musik GmbH is a typical example of a medium-size German company. It was formed 20 years ago and makes parts for hi-fi speakers. Most of its customers are small to medium-size European and North American companies who sell their speakers to hi-fi enthusiasts. The typical prices of the speakers that use Fröse Musik's parts are 750–5000 €.

Axel Fröse, the founder is about to retire and will be replaced by his daughter. What should her strategy be?

Solution

Ulla Fröse, having just completed an MBA, knows that a SWOT analysis, done using the various tools at her disposal and shown in the following table, is the best starting point.

Strengths	**Weaknesses**
Excellent quality Innovative R&D Costs are under control	Too much stock Cash flow could be better Sales have declined by 10% over the last 2 years Occasional delays in production meaning deliveries are late
Opportunities	**Threats**
Similar technology used in other types of consumer products, e.g. TVs and laptops	Market for high-end audio has shrunk by 15% over the last 2 years Chinese competitors with similar products

The company obviously faces some difficult short-term and long-term problems. Ulla decides that her priority must be to fix the cash flow problem, after which production processes should be analysed and improved. She is mainly concerned, though, by the fact that the decline in the market for high-end audio is declining and that this is affecting the sales of Fröse Musik's components. This situation is made worse by the entry into the market of Chinese competitors.

She thinks about the four growth strategies. She rejects the idea of introducing new products to their existing market (product development) because the market is in overall decline and she does not immediately intend to offer new products on a new market (diversification), not least because cash flow issues mean that there is not enough money to invest in new development, even though the R&D department is very good.

She could try to increase market share among high-end speaker manufacturers (market penetration), but the decline in the market implies that any gains will be limited, particularly given the existence of the Chinese competition. The most promising strategic option is market development—Fröse Musik can sell its existing products to TV manufacturers and to the producers of any other technology that has speakers. If this is successful, Müller Musik could take advantage of its R&D capabilities to develop new products for this new market.

9.5.4 Portfolio Analysis and Strategy

A firm that is involved in more than one market needs to manage the range of goods and services it offers in order to achieve the optimum allocation of resources. A Boston Consulting Group matrix is a useful tool for this.

Situation
A manufacturer of soft drinks sells three types of product: cola drinks, fruit juices and bottled water. Its senior managers need to know where to invest the company's resources.

Solution
David Connolly, one of the assistants to the CEO performs an analysis of the product portfolio using a BCG matrix. All figures in the following table are millions of euros.

	Cola drinks	Fruit juices	Bottled water
Sales last year	350	50	200
Sales this year	325	52	280
Sales next year (forecast)	295	53	350
Market size last year	900	800	500
Market size this year	910	820	750
Market size next year (forecast)	920	820	950

David then produces the following table based on the forecasts for next year and market growth since last year.

	Market share (%)	Market growth (%)
Cola	32	2
Fruit juices	6	2.5
Bottled water	36	47

These data are used to produce the following matrix (Fig. 9.25).

Based on this matrix, David predicts that senior management will probably decide to invest heavily in bottled water and avoid investing too much in cola drinks, where the goal would be to maintain the competitive position. The fruit juice business is not in good condition—it would not be suprising to David if senior management decided to abandon that market.

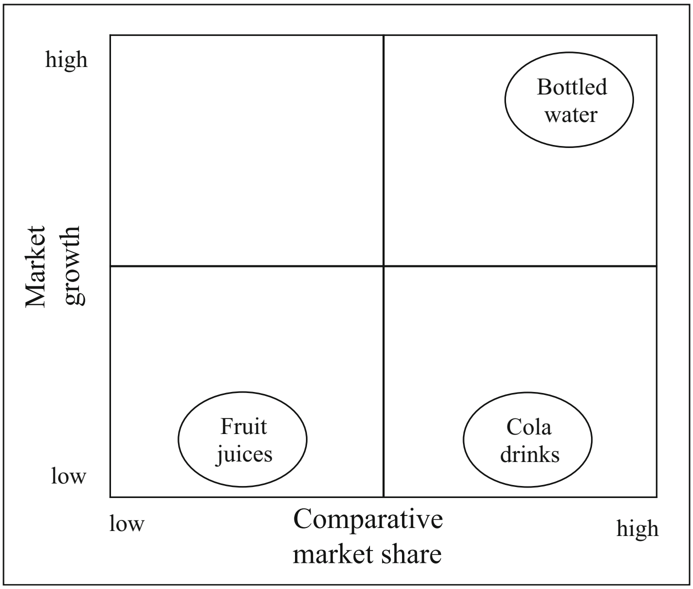


Fig. 9.25 BCG matrix

9.5.5 MyCompany Project

As mentioned in the previous chapter, you are going to open a second cafe and need a manager. You are going to place advertisements on several web sites and also inform the local Job Centre.

- What are you looking for in a cafe manager? What skills, competences and abilities will they need? What knowledge? What kind of experience do they need to have? Would you look for someone with a degree?

You are surprised, but happy, to receive over 30 applications, so you now need to think about the selections process.

- What questions would you ask in an interview? Assuming that you are looking for someone who is good at scheduling staff, how would you test for this during the selection process? After all, if you simply ask, "Are you good at scheduling?" every candidate will say, "Yes, of course."
- Would you involve anyone else in the selection process? What are the reasons for your answer?

You start thinking during the interview process about questions you would ask yourself.

- What skills and knowledge does the owner and manager of a chain of cafes need?

  The new employee will of course need to be paid.

- You will need to pay the legal minimum wage, of course, but will that be enough? Will you offer a bonus, and if so, based on which criteria?

Since you expect the good candidates to ask you about the business, and since you realise it is an important activity that should in any case be carried out on a regular basis, you want to prepare a SWOT-analysis.

- How would you find out the strengths and weaknesses of your business?
- Which opportunities and threats do you see in the outside environment?

9.5.6 Self-Test Questions

– *What advantage does a hybrid system have over purely functional and hierarchical systems?*
– *What are the core ideas of Peter Ulrich and Edgar Fluri?*
– *Describe a goal matrix.*
– *What are the elements of management systems?*
– *What different kinds of knowledge exist and how do they relate to management?*
– *Why do many business entities use a Balanced Scorecard ?*
– *Describe the budget system of a multi-level concern,*
– *What is the connection between organisational structure and organisational process structure?*
– *What different types of controllership can be distinguished and which principles are essential for its success?*
– *What are the main responsibilities of human resource management?*
– *What are the elements of the management process?*