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Learning materials

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2 Prerequisites for Effective Departmental Management (The Organizational and Economic Structure of a Company)

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The continuous development of controlling functions and the growth of controlling tasks will lead to changes in the organizational structure of companies. To introduce controlling into a company, a corresponding institutional basis has to be created. The localization of a controlling department in the organizational structure of a company depends on certain factors. Mikovcová (2007, p. 18) distinguishes these factors into external and internal. **Internal** factors include:



- an increase in quantity, timeliness and complexity of the problems,
- the size of the company,
- the existing principles of company's management,
- the progressiveness of used technology.

External factors mainly include:

- the existing labour market, the market of goods and services, the money and capital markets,
- the political, technological, legal and social environment of the company,
- the economic structure of the country.

To select a specific of controlling department to be type incorporated into the organizational structure of a company, the following questions have to be answered: (Horváth, 2011, p. 738)

- At what point and in which form should the controlling functions be incorporated into the organizational structure of the company?
- Which tasks should be assigned to the controlling department of the company?
- What requirements are imposed on the controller?
- How should the controlling concept be implemented?

Finding the answers to these questions can be very problematic. Based on personal experience, everyone envisions a different “perfect picture” of what a controlling organization should look like. In this context, Eschenbach (2004, p. 127) refers to the fact that there is **no ideal controlling organization**. The question is whether controlling tasks should be fulfilled by separate specialized units, or whether it is possible to implement these tasks as “a secondary activity” in other departments of a company. In practice, the controlling department may be known as the economic department, the department of planning and calculating results, administration or commercial services department.

In literature, it is basically recommended that the controller should be a member of the top management. This increases the efficiency of their work because he or she has sufficient independence. Horváth (1998, p. 810) highlights that the controller should be separated from the executive level and be able to comprehensively monitor and coordinate business activities.

This solution also causes some problems. A controller who is involved in the co-decision making procedure verifies and assesses his own decisions. Another problem is that a controller who is at the highest management level may not be able to guarantee the highest possible expertise in all areas of business activities. For these reasons, the best solution seems to be the integration of the controller into the second highest hierarchical level. The controller can be subordinated to the CFO, who is a member of the company’s top management.

If controlling is placed at lower levels of company’s management, it usually does not bring expected results. In order to take efficient and independent action, the controller would therefore need: (Eschenbach, 2004, p. 134)

- to be able to carry out his or her tasks objectively and independently,
- to have, in spite of his or her relatively low position in the company’s hierarchy, immediate access to top management and regular contact with it,
- to have the necessary authority to carry out executive functions allocated to him or her.

2.1 The introduction and reorganization of controlling

Because the internal and external environments of companies are changing, it is also clear that the organization of controlling departments have to change. In this context, Horváth (2011, p. 797) distinguishes two basic situations:

- the company has **no controlling system** and it has to be created,

- the company already has a **controlling system** that has to be **transformed or expanded**.

In the first case, there are always some components of a controlling system in a company. Each company has a planning process and also keeps accounts in a certain way. Management has to coordinate business activities from time to time. A controlling system is created only when planning, control and information gathering are united with each other and the company is able to fulfill its set objectives. Horváth (2011, p. 797) identifies this situation as **metacontrolling**.

In the second case, the controlling system should partially or totally adapt to new situations on a profit-oriented basis. Such reorganization measures are commonly taken and the controlling system requires constant checking. The controller's task never ends. This solution requires continuous improvement – the use of kaizen techniques.

In both cases, a certain methodology has to be used during the reorganization process. To reduce the risk of failure, Eschenbach (2004, p. 129) recommends **following certain steps**. First, only individual functions of controlling (e.g., corporate planning and budgeting) are introduced. Subsequently, larger parts of the controlling concept are introduced in selected parts of the company (e.g. in one operation or in one division). Through this selection, the preparedness of the staff that will work on this project should be taken into account.

To introduce controlling successfully into a company certain obstacles have to be overcome. These obstacles can be described as **critical factors of success**. The linkage of these factors to the process of implementing controlling into a company is seen in figure 2.1.

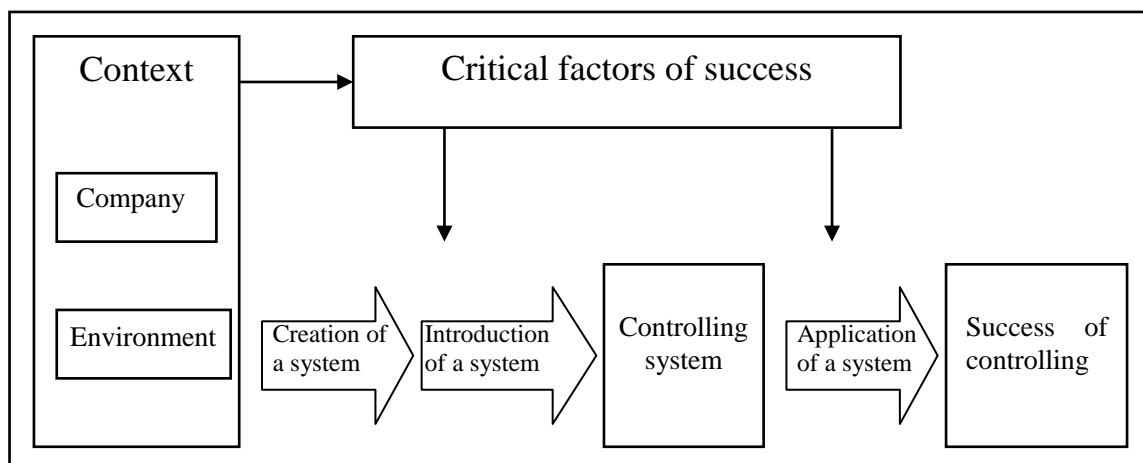


Figure 2.1 Situation model of the controlling
Source: ESCHENBACH, R. Controlling, p. 580.

Critical factors of success can be distinguished into two groups. The first group should be taken into account especially in the **conceptual phase** and the **implementation phase**. The second one should be reflected in the **enforcement phase**. The boundary between these two groups is continuous because some factors of success that are applicable in the previous phase also remain valid during the further development of the controlling system. The factors of success are characterized in table 2.1. (Eschenbach, 2004, p. 585)

Table 2.1 Critical factors of success and their scope

| Categories of critical factors of success | Scope |
|---|--|
| Factors of success with respect to acceptance | Acceptance of a controller and controlling by the staff, acceptance of external and internal information published by controlling |
| Factors of success with respect to behaviour of business management | Individual and group behavior of a controller and a line manager |
| Structural factors of success | Organizational linkage of controlling, level of decentralization, cooperation with other areas connected with controlling |
| Process-oriented factors of success | Creation and enforcement of the controlling process, realisation of planned objectives through individual activities and measures, communication processes |
| Business factors of success related to content | Creation of the content of the controlling system, e. g. range of cost calculation, MIS |
| Factors of success related to power | Power (formal power, expert power), competence and responsibility of controlling, alliance with promoters of power (formal, informal) |
| Factors of success related to resources | Personal and technical background of controlling (qualitativ and quantitativ), staff know how |
| Factors of success related to development | Further development of the controlling system: learning function, ways of development of controlling (introduction, development, consolidation) |
| Factors of success related to corporate culture | Image of trust/distrust of a company, confidence in the controlling system, etics, clarification of its sense |
| Factors of success related to complexity | Simplicity, speed, confidence in controlling and in business management |
| Factors of success related to personality | Personality characteristics of a controller, professional know how, basic social, political and business knowledge |

Source: Modified by ESCHENBACH, R. Controlling, p. 586.

Implementing controlling is a complex process that can cause a variety of problems. For instance, management can resist the introduction of controlling into their company. The reasons for this behavior may include the following: (Eschenbach, 2004, p. 129)

- management is afraid of losing power,
- existing financial and accounting departments are afraid of a new competitor,
- the sales department expects that its results will be checked,
- the manufacturing department expects the introduction of unpleasant efficiency checks.

The implementation and customization of controlling is not possible without the people who are involved being adequately motivated. The support of company's management is, therefore, urgently needed. According to Horváth (1998, p. 799), the introduction of controlling is a **strategic decision** that exceeds the whole process of organization. It is, therefore, dependent not only upon approval, but also upon the support and active participation of company's management. Reorganization plans are usually implemented

without major problems. Fundamental decisions about the implementation of controlling have been made and there is no danger that the overall concept will fail.

2.2 Line versus staff structure

The position of a controller can be established either as a line or a staff position in a company's organizational structure. Eschenbach (2004, p. 130) raises the question whether or not the controller should have decision-making competencies. The final decision will largely depend on the top management's understanding of the role of controlling in their company, i.e. whether controlling is considered support for company's management or if it is understood as a direct management function. In this context, it is necessary to mention the level of development of controlling in a company. The more completely the controllers fulfill their role, the easier their activities can be regarded as the exercise of a linear position.

If controlling only fulfills a service function, i.e. it supports the company's management, then it is established as a **staff department**. The controller, therefore, is part of the company's top management, e. g. of the Board of Directors. His or her task is to prepare decisions and measures and evaluate information, coordinate sub-plans and supervise the implementation of decisions taken. In this case, the controller generally does not have the necessary competence for decision-making and coordination functions. He or she is, therefore, entirely dependent on the support of top management in these situations. A simplified organizational scheme is shown in figure 2.2.

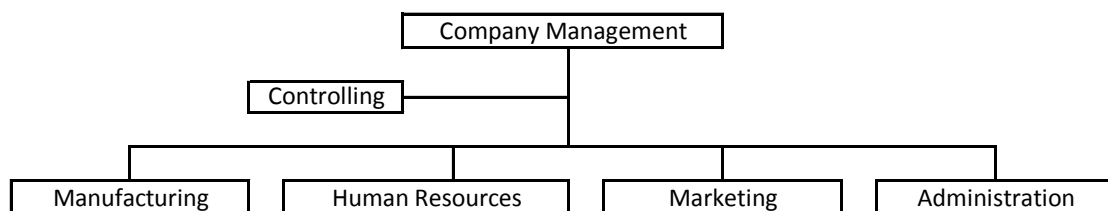


Figure 2.2 Controlling as a staff structure

Source: Modified by MIKOVCOVÁ, H. Controlling v praxi, p. 20.

In literature, it is argued that the purely staff function of a controller does not exist. According to the following argument by Mann (1989, p. 177):

- in addition to service tasks, a controller also has some decision-making skills; for example, he or she may use the help of top management when serious deviations occur,
- a controller, as a staff department, has to rely on the support of their superiors, which means losing authority,
- the activity of a controller is so important to a company that he or she must have the right to dictate.

If the role of a controller is assumed to be **linear**, the controller has evolved from a purely advisory body to a person who is responsible for decision making. This model can be applied especially in crisis situations. On the other hand, in the normal operation of a company, this approach has a relatively low stability. This solution can be

acceptable if controlling is allocated to the lower levels of management. This situation is schematically illustrated in figure 2.3.

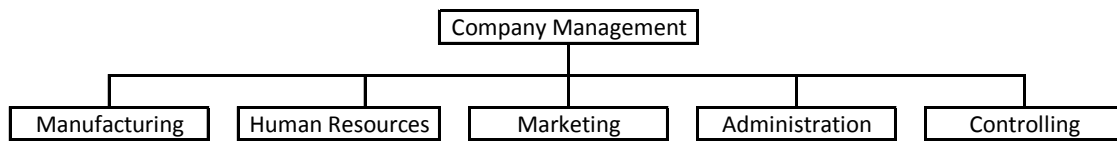


Figure 2.3 Controlling as a line structure

Source: Modified by MIKOVCOVÁ, H. Controlling v praxi, p. 20.

2.3 Centralization versus decentralization

Controlling is generally understood to be a service function of company's management. Therefore, centralization or decentralization of controlling functions depends on the degree of a company's centralization of management functions. Controlling functions can be assigned to each level of management in different ways. Horváth (1998, p 809) recommends that the capacitive load of managers, the issue of the quality of decision making and the need for coordination should be taken into account. Practical experience shows that with a certain degree of decentralization of management tasks, the service function also has a tendency towards decentralization.

In small companies, the function of a controller is usually performed by the owner or sometimes even moved to an external consultant. This solution is economically beneficial for small companies because it neither requires the employment of qualified personnel nor the creation of specialized controlling departments. A separate controlling department exists in companies of a certain size. For large companies, the decentralization of controlling functions is typical. Controllers in this case may act as: (Horváth, 2011, p. 750)

- a **functional controller** where the controlling department is a part of individual functional areas (Funktionsbereiche), for example research and development, purchasing, manufacturing, sales or finance and administration (see figure 2.4),
- a **divisional controller** where the controlling department is a part of individual product groups (Produktgruppe) (see figure 2.5),
- a **regional controller** where the controlling department is a part of appropriate regional divisions.

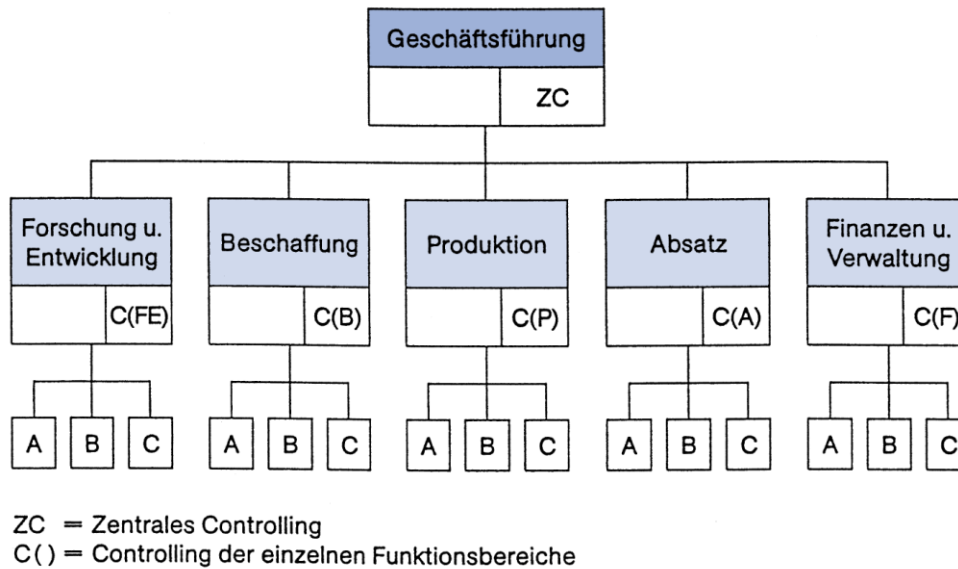


Figure 2.4 Decentralized controlling in a functionally structured company
Source: HORVÁTH, P. Controlling, 2011, p. 751.

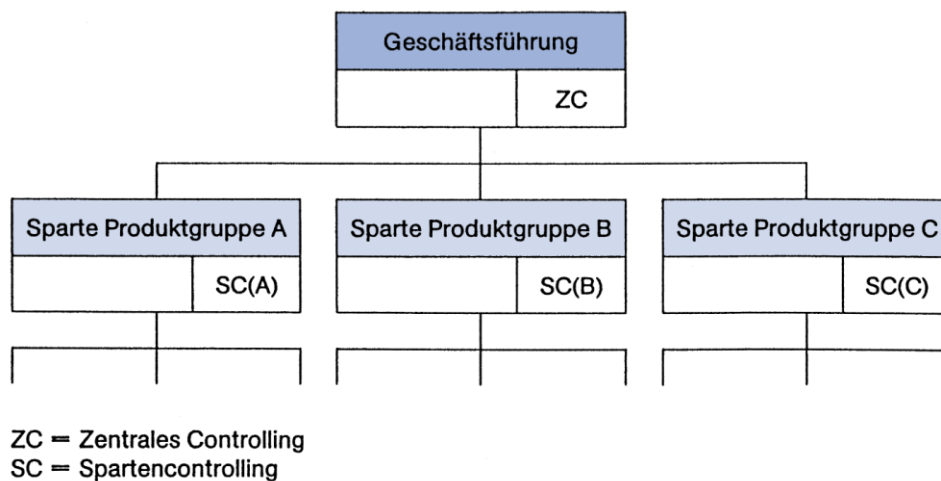


Figure 2.5 Decentralized controlling in a divisional structured company
Source: HORVÁTH, P. Controlling, 2011, p. 751.

Horváth (2011, p. 751) also deals with the question of whether central controlling should be placed on the first or second level of the company's management. If the controller is incorporated into the first level, he or she is part of the top management and he or she is a neutral voice that cares about the result orientation of the total business perspective. If the controller is incorporated into the second level of company's management, there is "a certain distance" between the controller and management. In this case, the controller is usually a member of the department that is in charge of corporate finance. In general, it can be said that the inclusion of a controller must enable the fulfillment of their tasks. This is schematically shown in figure 2.6.

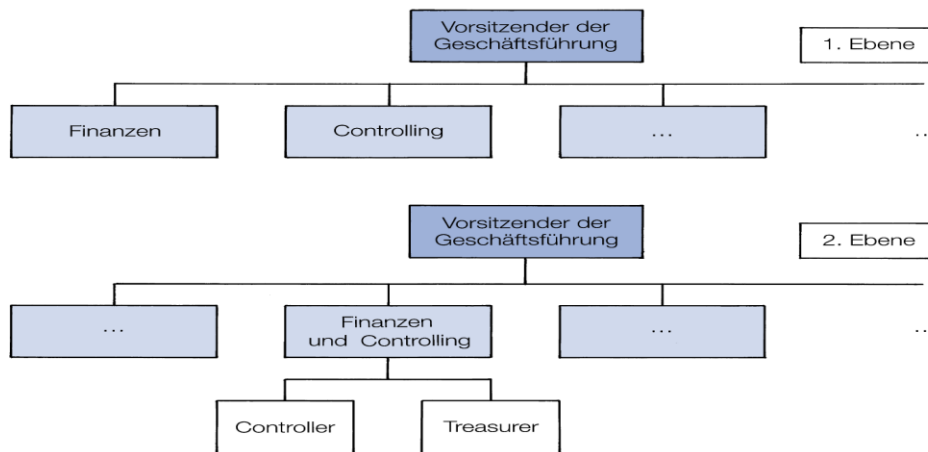


Figure 2.6 Typical inclusion of the (central) controlling the corporate hierarchy
 Source: HORVÁTH, P. Controlling, 2011, p. 752.

It is possible to say that both purely decentralized and centralized controlling has significant shortcomings. Horváth (2011, p. 752) argues that, in practice, a mixed structure is used. This type of integration of controlling into a company's organizational structure is called a **dotted line structure**. The structure combines the advantages of both professional and decision subordination. In terms of **professional subordination**, the methodology is set out and the compliance of tasks is ensured (e. g. reporting guidelines). **Decision subordination** includes competencies for managing employees (employment contracts, compensations, etc.). This double integration of decentralized controlling means that when a controller makes decisions, he or she is subordinated to the relevant line manager and professionally he or she reports to a central controller. This double subordination may also lead to conflict situations. This structure can have a very complex character when applied in large companies and international concerns, which is presented in figure 2.7.

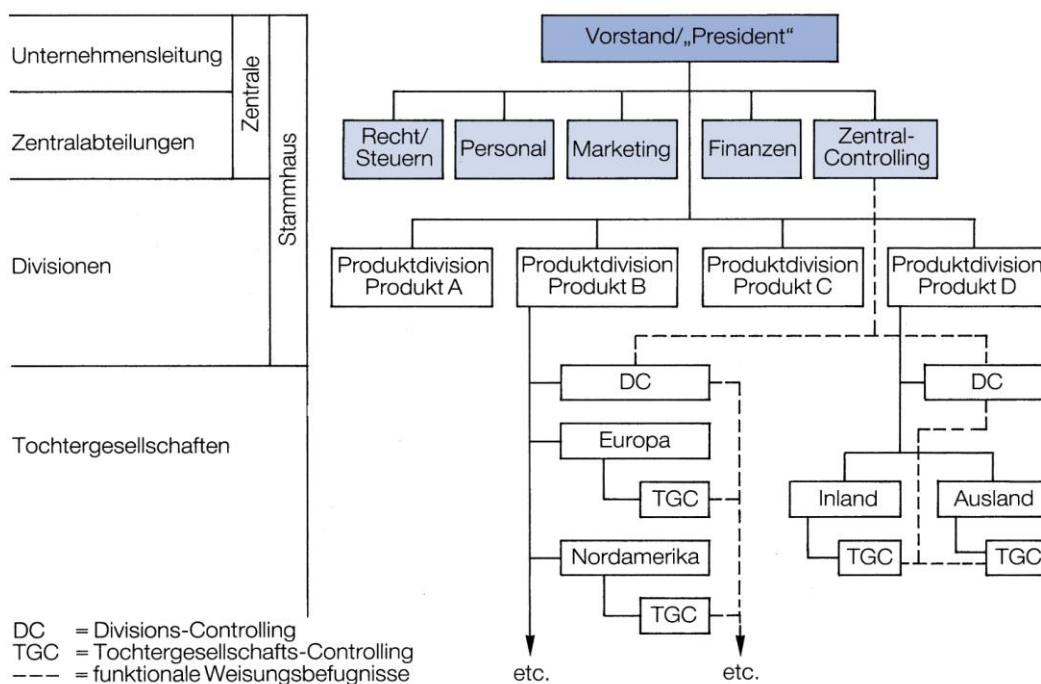


Figure 2.7 Structure „dotted line“ in an international corporation
 Source: HORVÁTH, P. Controlling, 2011, p. 754.

All the above-mentioned variants of the incorporation of centralized or decentralized controlling into a company's organizational structure have some advantages and disadvantages. The main strengths and weaknesses of the individual solutions are shown in table 2.2.

Table 2.2 Strengths and weaknesses of possible variants of cooperation between centralized and decentralized controlling

| Option | Potential strengths | Potential weaknesses |
|---|---|--|
| Decentralized controlling which is subordinated to central controlling | A good cooperation and a good information flow between a central and a decentralized controlling. Lean organization of controlling. Ensuring of the uniformity of the controlling system | The affected business area sees its controller as a foreign object or even as a spy. Decentralized controlling is oriented too centrally and it supports the unit too little. |
| Decentralized controlling which is subordinated to the head of a specific business area | The decentralized controller is understood by the "affected business area" as its own controller. He is accepted, he has the access to all information sources of the affected business area and he can act appropriately | The central controller has no ability of the resolute intervention and he has to use his personal charm or formal authority. The controller of the affected business area can be degraded to an administrator of the affected business area. |
| Dotted-line principle | Ideally, the mentioned strengths are combined without occurring any weaknesses | Dubble subordination of a decentralized controller can lead to considerable conflicts which puts high requirements on the skills of a decentralized controller |

Source: Modified by ESCHENBACH, R. Controlling, p. 136.

2.4 The internal structure of the controlling department

As in other departments of a company, specialized controlling positions are created in controlling departments. The controlling department can be organized according to: (Mikovcová, 2007, p. 21)

- **activities** – there is a controller for business planning and budgeting, for reporting, for analysing investments etc.,
- **functions** – there is a marketing, purchasing, logistic, personal and project controller,
- **recipients** – this is typical for divisional organizations and international companies where there is a divisional or regional controller.

As already mentioned above, the ideal organization of a controlling department does not exist. The controlling functions and the organization of the controlling are unique with respect to the needs of the individual company. Horváth gives a model organization of a controlling department which is shown in figure 2.8.

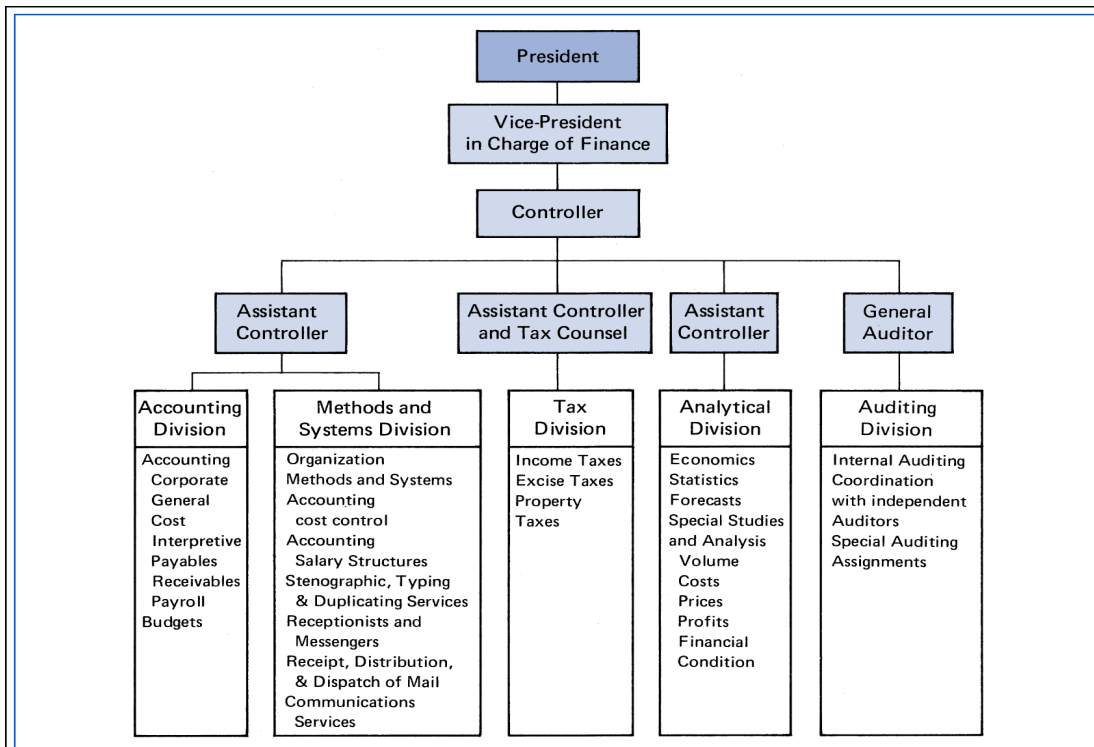


Abb. 7.3: Controllingorganisation in „großen“ Unternehmen
(The Prentice Hall 1975, S. 41)

Horváth, Controlling, 12. Auflage

© Vahlen Verlag

Figure 2.8 Structure of a controlling department

Source: HORVÁTH, P. Controlling, 2011, p. 748.

Summary

To enable the proper functioning of controlling, it is necessary to incorporate it into the right place in the organizational structure. This gives the controller sufficient competence for making effective decisions. The way the controlling department is incorporated into a company is always dependent on the conditions in the specific company. In practice, there is no ideal organization of controlling.

When introducing controlling into a company, two basic situations have to be distinguished. Whether there is no controlling system in the company, or whether the current system should be transformed or expanded. It is always necessary to follow certain steps to prevent failure of the whole process. Given that a controller has considerable power, employees and management generally resist the introduction of controlling into a company.

When deciding whether controlling should be organized as a line or a staff structure, the company's specific conditions have to be respected. It is generally recommended that under normal operations, controlling fulfils more of a service function to the company's management. On the other hand, when dealing with extraordinary situations, controlling can also perform line functions.



The concrete organization of controlling in a decentralized company depends on its needs. Generally, three ways of organization can be applied – a centralized, decentralized and dotted-line structure.

When introducing controlling in large companies, it is also necessary to think about the controlling department's internal organization. This department can be organizationally arranged according to performed activities, functions or recipients.

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