THEORETIC ASPECTS OF FINANCIAL CONTROLLING IN THE FIRM

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Abstract: The focus is on financial controlling as part of the controlling in the firm. The article highlights the need of financial controlling Bulgarian companies. It explores the factors of the external and the internal environment of the company within the context of financial controlling as well as the types of controlling. The major financial indicators that are used as a basis for the formulation of the goals of the company are outlined.

Key words: financial controlling, goals of the firm, financial indicators.

JEL: G22, G28.

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The activity of every business is dictated by the pursuit of specific goals. No company would enter a market without knowing what the goals are and how to achieve them. Therefore, goal setting forms the basis of the business plan and the future development of every firm. The planning activities, the implementation of the plan itself, the control over the achieved results are a must for every enterprise. Big firms even have functional departments that organize these activities. Financial controlling derives information from each of the above activities and recommends what actions are to be taken to ultimately achieve the expected results set in the formulated goals.

Often, controlling in the firm is misidentified as control. The lack of a clear idea what exactly it is and what are its tasks often results in poor performance of the company despite its introduction. In such cases controlling is considered as a too complex management philosophy expressed in a higher form of control. Theory identifies this as a basic mistake in the use of controlling (*Shulte, 1996, S. 230*). This is also valid for financial controlling as part of the controlling in the company. Such misinterpretation of its tasks

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in the firms incurs additional costs for its organizing which are ineffective and adversely affect the achievement of the set goals.

In literature controlling is considered in the context of management, being aimed at coordinating the overall activity of the company and the achievement of the pre-set goals. (*Каменов & Асенов, 2010, с. 133)*. It is also considered as a system related to the management of the results achieved in the enterprise (*Каменов, 1993, с.29*). The tasks of controlling can be in various functional areas like logistics, marketing, staff. In such cases we speak of Logistik-, Personal-, Marketing-Controlling (*Shulte, 1996, S. 203*). However, the tasks of controlling can also be aimed at the achievement of the financial goals of the firm. From this viewpoint we should speak of financial controlling. The emphasis of the paper is on controlling focusing on the financial indicators and the setting of the financial goals in the company, i.e. on financial controlling. Thus, the **research object** in the paper is financial controlling. The **research subject** is its tasks. The supported **thesis statement** is that an effect of the financial controlling in the company can be achieved only when its tasks are clearly defined.

The aim of the paper is to reveal the role and the place of financial controlling in the activity of the firm. To achieve this aim the following **tasks** are set:

- To elucidate the nature of financial controlling;
- To identify the financial indicators at setting the goals in the firm;
- To outline the different types of financial controlling in the firm.

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The nature of financial controlling in the firm. The development of the concept of the finances of the firm also predetermines the shaping of certain trends in the development of the controlling in the firm. The financial controlling, as part of the controlling in the firm, is no exception. Extant literature outlines the following trends in the development of controlling (*Shulte, 1996, S. 202*), in particular and of financial controlling:

- higher complexity of the processes in the firm. The need of higher coordination between the processes requires the introduction of an information system to close the information cycle from planning to analysis and control;

- the analysis of the value of the share capital;

- the need of cost control in the company;

- the changes in the environment. The changes in the environment require orientation of the goals formulated by the management of the firm towards the changes in the environment and the future, not towards the past;

- the intensification of the competition between the firms that operate in the same industry.

The above trends in the development of financial controlling are not devoid of meaning. The activity of every company is predetermined by the pursuit of specific goals, which in the end find their expression in the financial aspect. From this point of view, the analysis of the value of share capital and the added shareholder value is now an issue, central for the management of the company (*Rappaport, 1998, p. 1*). This applies mostly for the publicly traded companies. The market value of the equity capital of such companies depends to an extent on the financial results and hence on the management. The control over the size of the costs is also in direct relationship to the financial results. The control over the size of the costs by limiting the opportunity to generate additional revenue or sources of financing may also be the only opportunity for the company to stay on the relevant market. On the other hand, the market environment, the firm operates in, is variable. Therefore, goal setting based on the information about a past period only, in the conditions of a changing environment, leads to impossibility to achieve them. The task on financial controlling is precisely to adapt the activity of the firm in line with the changes in the economic, political, technological, regulatory and the demographic conditions of the dynamic environment. Competition between companies is also important. Strong competition requires analysis of the activities of the main competitors and competitive prices, a market policy adapted to the changing market conditions, continuous cost control. The accumulation of new problems to the company in continuously changing competitive environment leads to the expansion of the tasks of financial controlling.

As already mentioned above, controlling is often associated with the concept of control, which is incorrect. It is rather a continuous circular process, aimed at regulating the activities of the company according to the changes in the environment. The purpose of introducing financial controlling in the company is to achieve the predetermined financial goals. It covers the activities of planning, control and analysis of financial indicators linked by the information system, based on the mentioned indicators. The role of controlling in the company is to validate the actions provided that there is no deviation from the set goals or give the impulse to change the goals in the case of unacceptable deviations from them. In the latter case it is a change in the goals of the company (*Илиев, 2010, с. 194-196*).

In theory controlling is also defined as a system comprising specific phases and processes (*Shulte, 1996, S. 202-203*):

- Controlling as an information process linking planning activities, implementation of the developed plan and control over the results. The planning, implementation and control activities are linked in a continuous chain process.
- Strategic and operational controlling. Depending on the planning phase, the controlling in the company can be strategic or operational. Operational controlling is associated with the development of specific accounts or budgets in the short run, including a a budget of revenue and expenditures, a budget of production costs of a specific product, sales plan, cash flow forecast, estimated balance etc.
- Functional controlling. It is directed to the main functional areas of the company such as marketing, supplies, staff, production, sales, finance.

While controlling can be directed to various functional areas of the activity of the company this paper focuses on financial controlling in the firm. This is the most important part of the controlling in the company because all elements of the activity of the firm ultimately find affect the financial results. Financial controlling is associated with the financial indicators and the financial goals in the company. The financial indicators can be measured as absolute values, for example, revenues from sales, profit or financial ratios. From the perspective of the planning phase operational controlling is directly linked to the setting of the financial goals of the company, expressed in the financial plans – of sales, of revenue and expenditures, of cash flows.

As a process, financial controlling always starts with goal setting. The goals in a company may be at various hierarchical levels. Therefore, there are goals of secondary importance and a main goal. The role of financial controlling is to assist the managers of the company in achieving the main or the leading goal. This goal may be formulated in a different way. Under the conditions of shrinkage of the market of a product or a service the main goal can be to stay on the market. From a financial controlling point of view, for such a goal the management of the company would be satisfied even with achieving a positive financial result. The activity of the company would be reduced to a volume where the revenue from sales covers the costs, including remuneration ones, which would allow management to avoid layoff of staff. It is possible to apply another approach in setting the main goal. The management seeks to increase its market share by increasing revenue from sales. In this approach the financial goal is to achieve a given growth of sales. A third approach in setting the main goal may be to retain market position or to remain among the leaders of the market. In this case financial goals are commensurate with those of the competitors in the industry. It is possible, managers to redefine their goals, which means that the guiding goal would become secondary and a new guiding goal would be formulated. Under the conditions of a developing capital market in Bulgaria the main goal for the publicly traded companies is not to achieve revenue from sales growth but to increase the market value of equity. The efficiency of controlling in a company depends on the degree of achievement of the main goal.

As a rule, the goals in a company are subjectively set by its management. Therefore, goals cannot be defined unambiguously and for different companies they are different. Typically, goals are quantified. Financial goals are set in financial indicators. When the goal is a growth in revenue from sales the question is how much this growth is expected to be. When a certain profit is being targeted the question is what percentage of the revenue from sales or what the margin of the profit in the company should be. Financial indicators have specific values. They are disclosed in the financial accounts of the company. To what extent the goals set by the management have been achieved can be assessed by the financial results reported in the annual financial statements of the company. Therefore, the published financial indicators can be considered an objective assessment of the extent to which the set goals have been achieved.

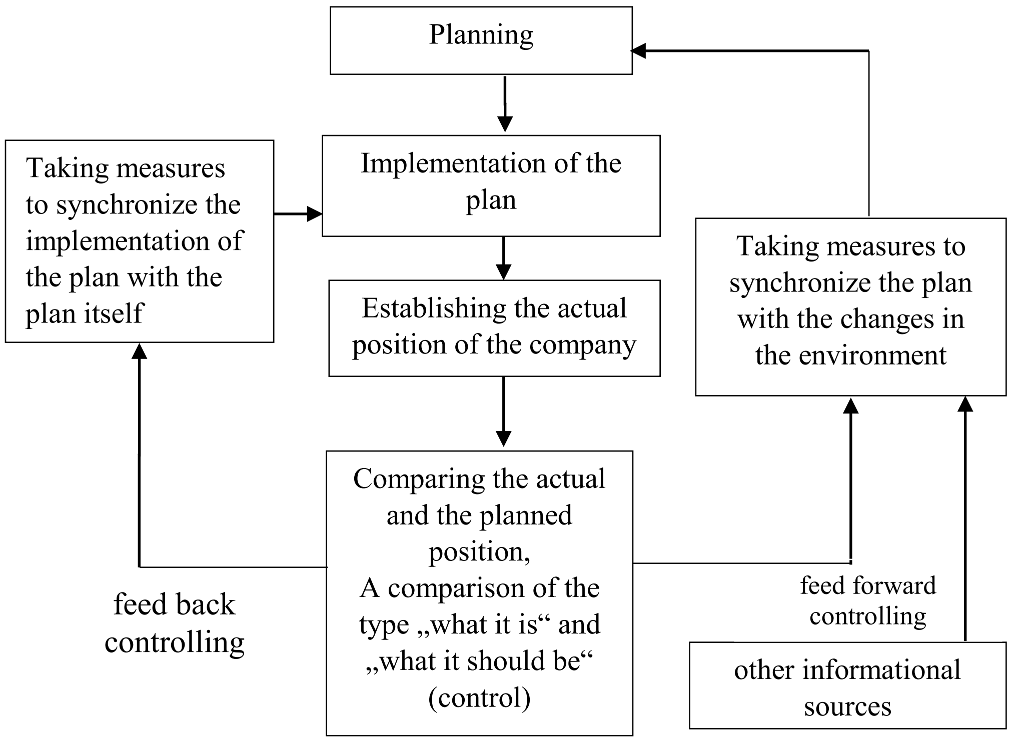
Tasks of financial controlling in the company. Financial controlling, as part of the controlling in the company, has its specific tasks. They are defined in the context of the benefits from its introduction and the assessment of its contribution to the results achieved. In German practice controlling as a process is widely used and is often linked to the results achieved. Financial controlling is related to the engagement of both human and time resources as well as of financial resource which also requires seeking financial effect from its implementation. The results achieved are usually associated with profitability indicators such as return on equity, return on investment, profitability of sales, cash flow profitability. These results are also related to the dynamics of the revenue from sales or the trend in the sales of the company in the industry. (*Shulte, 1996, S. 204*). The practice has shown that the results from the application of financial controlling in the company are ambiguous. A survey conducted in over 10 big corporations in Germany has found that there is variability in the achieved results in the individual companies. The most significant variability was found for the cash flow profitability indicator.[2] The firms from the survey were classified in six categories depending on the efforts and the amount of the financial resource for the implementation of controlling. They were labelled "excellent", "very good", "good",

[2] The cash flow profitability is the ratio between the operating cash flow and the revenue from sales in the company.

“satisfactory”, “poor” firms and firms that do not apply controlling. The firms categorized as excellent show the worst results compared to the average for the industry. On the other hand, the ones that have not applied the methods of controlling show results better than those of the excellent firms. On the third side, firms characterized as “very good” show results well above the average for the sector (*Shulte, 1996, S. 204*). The results of the survey show that financial controlling has a role in the management of the company. However, to achieve an effect from its application we need to invest not only financial but also human resources. We also need to clearly identify *the tasks* of financial controlling. *The main task* of financial controlling is to find out to what extent the set financial goals are achieved and to give an impetus for change in case there is a significant deviation from them. The tasks of financial controlling should not conflict with those of the functional departments in the company – planning, marketing, accounting, finance. The elucidation of the nature of financial controlling requires defining the place of controlling in the management structure of the company. The role of the Controlling Department is based on a built-in information system for collecting information from the functional departments of the company, processing this information and on this basis giving impetus for top management decisions. Therefore, the Controlling Department has no powers to make decisions but rather to inform the management of the company about the current financial situation and the deviations (if any) from the set goals. The final decisions are made by the managers of the company. For this reason, the Controlling Department is to be considered an adaptive unit that processes information from the various functional departments and later to give recommendation on decisions to the corporate management of the company (*Илиев, 2010, p. 91*).

Financial controlling should deal only with the financial parameters set out in the plan and to see to their implementation. The financial indicators that build up the information system of financial controlling have to be linked in a system. This allows the specialists that work at the Controlling Department to monitor the business processes in the company and in case significant deviations from the set goal are detected, to identify what the reasons are. Various information systems that link a number of financial indicators are known in theory and practice. Usually they have pyramidal structure that is topped by the main financial indicator that supports the main goal. The most famous of these is the DuPont system (*Захариев и др., 2016, pp 112-114*), but the systems „ZVEI” and „RL” are also mentioned (*Shulte, 1996, S. 411-415*). The main financial indicator is usually a profitability ratio for example return on invested capital or return on equity. It is also possible the main financial indicator to be an absolute value such as operating profit or net profit. It should be noted that in the analysed systems the mentioned indicators are planning values, i.e. they are subject to planning.

Another task of financial controlling is to reformulate the financial goals in case of essential changes in the environment. Practice differentiates between feedback and feed-forward controlling (Figure 1). Since financial controlling is part of the controlling in the company the figure below also applies to it.



Source: Shulte, 1996, S. 230.

Figure 1. ***Controlling of the type “feed back” and “feed forward”***

The main difference between the two types of controlling is that the former (feed back) focuses on the implementation of the developed plan and the latter (feed forward) – on changing the plan itself. Therefore, with controlling of the type “feed back” there is no change in the plan and in the set by the management goals. The task of controlling here is rather to stimulate the management to make a decision so that the set goals are achieved. Its task is, based on the informational system that links planning, control and analysis, to identify measures for the synchronization of the implementation of the plan with the plan itself. From the point of view of financial controlling the task is to achieve the set financial goals.

The change in the environment in which the company operates not always makes possible the achievement of the financial goals. In such a situation, both the plan and the goals need to be revised. The changes in the environment are related to the trends in the development of the market (market shrinkage or expansion), changes in the regulatory framework imposed by the European directives, the emergence of new companies and new products on the market, etc. The controlling of the "feed forward" type is aimed at changes in the plan and in the set goals in line with the changes in the environment. From the point of view of financial controlling the task is to adapt the activity of the company including the financial plans to the ongoing changes in the environment. The changes in the environment can endanger the activity of the company. The dynamic market environment requires the application of financial controlling in the Bulgarian companies, i.e. adaptation of the financial plans to the parameters of the changing environment. This requires, financial plans, and goals correspondingly, to be considered within the context of the marketing policy of the company.

Goals of the company in the context of the distribution policy. The main guideline for the activity of every company is the main goal, respect-tively the goals it pursues. The goals are to be seen as the expected result that the managers of the company aim to achieve. The goals are considered in the context of financial controlling. The formulation of the goals is the basis for the development of the business plan and the long-term goals are reflected in the strategy that the management of the company pursues. Not all goals of the company can be defined as quantities. Therefore, goals can be divided into such that are quantifiable, the value of which can be measured as a quantity, and such that have no value dimensions but rather qualitative ones. The figure below presents the goals in a company that are related to its marketing policy.

Goals in a company	
Quantifiable	Non-quantifiable
– Increase in the revenue from sales or "turnover" target; – Decrease in expenses; – Increase in profit; – Improved liquidity of the company.	– Availability of the products offered; – Increase in market share; – The products reach the target groups; – Building and maintaining an intended image.

The figure is based on: Shulte, 1996, S. 8.

Figure 2. ***Goals related to the marketing policy of the company***

The goals that are not quantifiable have a direct impact on the ones that are. The image of the company directly influences customer behaviour. Customers are more likely to buy a product or a service from a company that has an established image in the industry, which provides a competitive advantage. Therefore, the image of the company is directly related to its sales, respectively its turnover.

The increase in the market share is also a result from the increase in the revenue from sales. The increase in the market share is to be considered in two ways. The first is an increase of the total market share of the company. It is directly related to the increase in the revenue from the sale of all products the company offers. The second direction is associated with the increase in the market share of a specific product.

The availability of the products offered has a direct bearing on the image of the company therefore on its sales. With the advent of online commerce, the availability of the products offered is of particular importance. In the practice of online commerce there are a number of cases where, despite the request of a particular product (labelled as available) the company refuses to deliver the product within the specified time limits. This discourages customers to make subsequent purchases, which directly affects the image of the company.

The goals related to the distribution policy are predetermined by the influence of specific factors. Both the external environment the company operates in and the internal environment are of great importance. External factors are objectively given so the managers of the company are not able to have an essential influence on them. External factors include the economic conditions, the competition, the legal or the regulatory framework and other. Internal factors are directly related to the type of the products offered, their price, the mode of distribution, the advertising policy, the size of the company and its financial potential (*Shulte, 1996, S. 8*). There external and internal factors have a direct impact on the distribution policy, respectively on the goals related to it. In the conditions of shrinkage of the market for a specific product or service to achieve growth in the revenue from sales is a difficult task. Therefore, the way in which an industry develops, or the trends in it are of importance. An important factor that influences the goals of the company is the presence or the absence of competition. The entering of a new product or service in a market as well as producing of an existing product by competitors in the industry but at significantly lower costs diminishes the comparative advantages of the company. The presence of the so-called barriers to entry in a business reduces competition which provides benefits for the management of the companies that are licensed to operate in a specific sector or industry. On the contrary, the presence of strong competition puts the management of the company in a constant competitive struggle to maintain the market share by competitive prices, improved quality of the service offered, new distribution channels. Not less important is the legal regulation of the activity of the companies that operate in an industry or a sector of the economy. The liberalization of a market such as the European one, allows the entering of foreign companies of a particular branch of the economy in the Bulgarian market, and vice versa. The liberalization of the market towards the free offering of a product or a service changes the economic situation in a given industry or sector of the economy and directly influences the market environment the company operates in.

The external environment the company operates in is variable, while the internal environment of the company is under the control of its management, i.e. it is determined by it. As noted above, one of the tasks of financial controlling is to adapt the activity of the company to the changing external environment to achieve the set financial goals. The way the goals in the company are set is of interest.

Financial indicators in formulating the goals in the company. The formulation of goals requires setting of target values. In terms of financial controlling these are specific financial indicators. In the literature on controlling there are described a number of options to formulate the goals in the company based on financial indicators. For example, an increase in turnover compared to the previous year by 10%, an increase in the market share by 5%, return on equity 12%, profit from sales 25%, development of a sales plan for $400 000 a year for a given business unit (an agency or a representative office). These indicators are also known as *target indicators* (*Дайле, 2001, pp. 22-23*). The development of the individual planning budgets, including the sales, production, procurement, revenue and expenditure, is based on set goals (*Дайле, 2001, pp. 22-23*).

The above mentioned target values are quantified but not substantiated. As a rule, the goals are subjectively determined but they are always developed on a specific basis. The basis for the development of the goals can be various - the internal plans of the company (internal information), comparison with the competitors or the leading companies in the industry (benchmarking), historical data. It is possible the goals in the company to be developed on the basis of average values for the analysed industry. These usually are target values expressed in financial ratios. Such values are cash flow profitability, return on investment, return on sales, return on equity.

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The clarification of the essence and the role of financial controlling in a company requires the clear identification of its tasks. Its main task is to achieve the set financial goals. As a rule, the goals are subjectively determined by the management of the company but they are always developed on a given basis and are set as early as at the planning stage. The goal may be to remain in the industry, to achieve a given growth in the sales revenue, to maintain the leadership position in the industry, to expand market share. Therefore, the goals, as noted above, are subjectively determined by the management of the company and may not always be unambiguous. They may have both financial and non-financial values. However, in the end, the non-financial ones also influence the financial goals in the company. From this point of view, on the top of the hierarchy there always is a financial indicator the value of which can be measured. The modern concept of the subject of corporate finance regards the increase in the market value of equity as the main goal of the management of the publicly traded companies. Therefore, the goals "turnover", "profit", "return on equity" should be considered secondary goals, which, however, have a direct bearing on increasing shareholder wealth. The developing capita market in Bulgaria also determines the need to introduce a Controlling Department in the structure of the public companies. Such a department should also be established in all major financial institutions such as banks and insurance companies.

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