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## THE CONTROLLER'S FUNCTION IN STABILIZING CRISIS IN AN ENTERPRISE

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**Summary:** The paper presents a crucial role of controller in stabilizing crisis in a company at the very beginning of an acute crisis. It is divided into four sections. The first part explains what a crisis emergency phase in a turnaround process is and what general rules are applied while stabilizing a crisis in a company. The next three sections deal with the functions of a controller in reference to three pillars of a crisis stabilization, including: short-term cash management, new principles of managerial and financial control, and preliminary cost reduction.

**Keywords:** crisis stabilization, short-term cash management, managerial and financial control.

### 1. Introduction

How should managers understand a crisis in reference to their businesses? Should they perceive it as an event which implies changes or perhaps as an uncontrolled situation which unfavorably affects day-to-day operations and overall business performance?

The Chinese philosopher Lao Zi, who lived over 2500 years ago, remarked that people often fail when they are about to succeed. Moreover, if they remain as careful at the end as they were at the beginning, there will be no failure. It seems to be a paradox that people fail being very close to a success. However, in a business practice corporate successes and failures proved to be closely associated. The corporate history saw many businesses perceived as successful just on the eve of their failure.<sup>1</sup> We can even claim that a success itself and the things that contributed to it will belong to the causes of a future decline. Therefore, in order to remain competitive and successful, companies have to master “perils of excellence” [Clarke, Dean, Oliver 2003, p. 15].

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<sup>1</sup> See the stories of energy-trading giant Enron and large auditing company Arthur and Andersen in: [Bazerman, Watkins, 2004, p. 43].

The last year 2012 and the first quarter of 2013 went by and left no doubt that Polish economy has reached an impasse. Polish commercial courts announced bankruptcies of 900 entities between March, 2012 and February, 2013 whereas a year earlier in the same period 751 corporate collapses had been recorded [*Upadłości firm w Polsce...* 2013, p. 1]. Adverse effects of an economic crisis did not get around large and well-known companies listed on the Warsaw Stock Exchange as well. Although some business failures particularly in the construction sector arose as a result of an external knock-on effect, still a considerable number of bankruptcies are caused by internal factors recognized as mismanagement.

This paper explores a crucial role of controller in stabilizing crisis in a company at the very beginning of an acute crisis. Although the role of a controller is limited to executive function only, whereas a turnaround leader sets priorities and determines objectives during an emergency phase of a turnaround process, it cannot be underestimated. Success of the whole recovery process depends on efficient planning, controlling and coordination of particular actions within turnaround strategies. The topic discussed in this paper is present in the latest scientific studies concerning turnaround process or an impact of crisis on management control systems and controller's duties. N.H. Haron, I.K. A. Rahman and M. Smith provided a longitudinal view of successful turnaround phases and explored how management accounting practices contributed to performance improvement of a company during revitalization [Haron, Rahman, Smith 2013, pp. 100–112]. J.A. Asel examined how companies adapted their management control systems to the changing environment caused by the financial crisis in 2008–2009 [Asel 2009, pp. 1–12]. V. Perovic, B. Nerandzic and A. Todorovic discussed a role and an organization of controlling and duties of controllers in times of crisis [Perovic, Nerandzic, Todorovic 2012, pp. 2101–2106]. E. Giacosa and A. Mazzoleni analyzed whether recovery projects conducted by companies in crisis required an introduction of new management control systems or changes to the existing ones. They stated that management control system fulfills a double function [Giacosa, Mazzoleni 2012, pp. 1326–1337]. Firstly, it is expected to predict poor financial situation using early warning indicators. Secondly, it is supposed to produce information supporting communication process with stakeholders. Although the abovementioned studies are quite new, the concept of controlling in a turnaround process appeared much more earlier in a monograph of F. Kall [Kall 1999].

This paper is divided into four sections. The first part explains what a crisis emergency phase in a turnaround process is and what general rules are applied while stabilizing a crisis in a company. The next three sections deal with the functions of a controller in reference to three pillars of a crisis stabilization, including: short-term cash management, new principles of managerial and financial control and preliminary cost reduction.

## 2. A crisis emergency phase in an enterprise

The stabilization of an acute crisis in a troubled organization should start at the very beginning of a turnaround process, just after the economic position of a company is diagnosed. During this process all efforts are supposed to be concentrated on providing adequate bridge financing, evaluating departments, subsidiaries or business operating units and reinstating financial discipline. Bridge financing is a method which aims at maintaining liquidity while awaiting future cash inflows. Such actions rely on both obtaining support from external lenders and managing working capital more efficiently by exercising rigid control over cash flows [cf. Bibeault 1999, p. 118]. Following evaluation of all operating units in a company, decisions on divestment or liquidation may be considered. Control of cash outflows and elimination of creative accounting practices contribute to restoration of financial discipline.

The crisis emergency phase is built on three pillars presented in Figure 1.



**Figure 1.** The pillars of crisis emergency phase

Source: own elaboration based on [Slatter, Lovett 2004, pp. 128].

It is worth noticing that D.B. Bibeault separated the emergency phase from the stabilization phase of a turnaround process [Bibeault 1999, p. 237]. The objective of the emergency stage is to obtain positive cash flows by a distressed company and thus ensure its survival, whereas the stabilization stage aims at restoring solid profits by running the existing operations more efficiently. The first phase lasts up to three months after the arrival of a turnaround leader. Then the second stage starts and does not have a planning horizon longer than one year as a rule. Interestingly, companies should begin their revitalization after the emergency phase by targeting small, isolated, and peripheral operations firstly, instead of large, central and core operations [Beer, Eisenstat, Spector 1990, p. 6].

During the emergency phase of a turnaround process a crisis leader should remember about five rules which have an impact on decisions and actions when a crisis in a distressed organizations is being stabilized [Slatter, Lovett 2004, pp. 128–129].

First of all, accountable cash management is one of the most important matters, since cash, as some leaders say, is “a king” or “a lifeblood of an organization” in colloquial language. In a situation of deepening liquidity problems a troubled company should be more vigilant about cash management than ever before.

Secondly, an environment of the organization consists of stakeholders. They put their trust in an organization but at the same time they put a pressure on managing cash flows effectively.

Therefore, rebuilding trust among stakeholders is the next step towards crisis stabilization. After winning quick cash a crisis leader has time to restore confidence among stakeholders and convince them about legitimacy of a crisis stabilization strategy.

Thirdly, setting priorities and delegating responsibility and authority in all the levels of an organizational structure contribute much to effectiveness of crisis stabilization. A turnaround leader has to revise objectives and responsibility rules within an organization in order to guarantee better transparency, efficiency and control.

A crisis stabilization requires *permanent* and *effective communication*. Internal communication should satisfy information needs and dispel doubts of management, employees and trade unions. External stakeholders ought to be informed that their interests are to be protected.

Cash management in times of crisis and new rules of control procedures should be implemented in a tense atmosphere of an *autocratic leadership*. A turnaround leader has to take control over a company, exact discipline and demand subordination from employees in complying with new rules and control methods.

### **3. Short-term cash management as a way for preventing an acute crisis**

During stabilization of a crisis short-term cash management refers to four activities, including: assessment of cash needs, development of strategies aiming at increasing cash inflows, implementation of severe cash management rules and monitoring of cash flows [Slatter, Lovett 2004, pp. 130–134].

#### **3.1. Duties of a controller in assessment of cash needs**

While assessing cash needs, a controller is supposed to draw up a detailed short-term cash flow projection in order to estimate cash needs. Such a cash flow projection should cover usually a period of 12 weeks. The first 4 weeks are to be planned on a daily manner, whereas the next 8 weeks can be organized on a weekly basis. It ought to be guaranteed, however, that a system is flexible. This means that it will enable to update cash disbursements and cash inflows day after day. We call such a solution a rolling projection. This kind of a forecast requires to make adjustments whenever unexpected expenses or incomes are encountered. Moreover, as one month ends, another month is added at the end of a rolling projection.

A controller, who projects cash needs, is supposed to consider only proven cash outflows and inflows. Furthermore, they are expected to take realistic assumptions while preparing cash flows projection. If a company cooperates with more than one bank, short-term cash projection should clearly distinguish relations with particular financing institution.

### **3.2. Controller's duties while developing strategies of streamlining cash flows**

An evaluation of an actual financial position of a company helps in preparing potential strategies aiming at improving cash inflows. Not only should strategies be identified, but also related advantages and costs. Moreover, all strategies should be carefully described and ordered according to their importance.

In order to develop strategies, a controller should prepare a formal plan which determines the sequence of particular actions within realization of a given strategy and appoints staff responsible for stabilizing a crisis in an organization. If established strategies do not bring expected results, a company should commence negotiations with external stakeholders aiming at collecting additional funds.

There are five short-term strategies which result in increasing cash flows, including: accounts receivable reduction, accounts payable increase, inventory reduction, deferment of planned investment and short-term external financial support [Slatter, Lovett, 2004, p. 135].

There are several factors which affect the size of accounts receivable, including: sales stability, sales terms, a volume of credit sales, a credit policy, cash discounts, a collection policy and a customer specification.

Accounts receivable management in times of crisis is based on an exact receivables collection. In order to achieve the best results, a controller should carefully monitor collections through continual aging of receivables. This precludes extending credit to customers who are late with their payments more than 30 days.

Collections can be improved by using dedicated accounts receivables system. It produces customer reports including all the information relating to a customer's receivables history. The system provides also a database showing numerical listing of transactions with subtotals by transaction types and delivers receivables aging reports which show all unpaid invoices and unapplied credits to each customer's account.

A controller should announce a conservative and stringent credit policy when a crisis is stabilized. Therefore, employees responsible for collecting cash from credit customers are expected to remind them of amounts they owe and deadlines when payments are due. Here special reports called statements of accounts play a significant role. They sum up recent credit purchases and cash payments of a customer and disclose how much money they owe to a company. The statements of accounts are sent to customers in order to inform them about their arrears.

Sound accounts receivable management in a crisis means prompt and regular collection of current receivables and maintenance of a short average collection period. It is connected also with careful analysis and evaluation of current customers in terms of their ability to meet financial obligations. A controller should also review conditions of payments respecting electronic payment options if they have not existed so far. Cash discounts for prompt payments and a renegotiation of payment terms should be considered accordingly.

Generally speaking, many companies in financial troubles cannot cope with doubtful or overdue receivables particularly if these problems arise as a result of customers' complaints about a quality of products or services. Therefore, a controller should assign a special team which will be responsible for solving litigations, establishing new days of payment and regaining receivables. Collection of doubtful or overdue receivables will contribute to additional inflows connected with return of VAT.

The next way for improving cash inflows is to increase accounts payable. Each attempt directed at extending a maturity date should be made with deliberation and caution since many suppliers disseminate information on their clients. If they pass a message that something wrong has happened with a company, then other suppliers may tighten sales conditions for fear of insolvency of a business contractor.

A distressed company can use a credit line as another type of current liability to pay for operational expenses. A revolving credit, which a company may draw as it needs, is less expensive than a loan for a fixed amount. Sometimes a troubled company should consider drawing secured loans which may also have a lower interest rate than unsecured loans.

In the situation of a cash crisis a controller should think over all the possible solutions that aim at streamlining cash flows. Therefore, attention should be paid to negotiation of the best conditions with banks concerning charges for overdrafts, fees, interest rates or credit lines. Moreover, a controller ought to monitor all transactions and regularly reconcile bank accounts tracking all discrepancies.

In times of a crisis better inventories management is a must. A controller should introduce a system of monitoring raw materials and finished goods which are not used. An excess inventory can cause liquidity problems by tying up cash which otherwise might be invested in more profitable projects. A well-balanced inventory level requires, however, a proper coordination of various organizational functions, including selling, purchasing and production processes. First of all, a controller should concentrate on getting rid of products obsolete or unattractive to customers. Secondly, the company should off-load buffer inventory level. The buffer stock level is a number of extra raw materials or finished goods which are stored in order to mitigate risk of shortfalls in a production process or unexpected deviations in supply and demand. In practice, off-loading buffer stock contributes to cash release, lower storage costs and avoidance of obsolescence problems. A company can adjust short-term production capacity to cyclical demand rather than increasing inventory.

Due to this strategy labor and operating costs will increase but cash which has been tied up in inventories so far will be released. This solution, however, is possible in an organization which does not have complicated operations. Other actions within inventory management cover regular reviewing and projecting orders and shipments as well as systematic stock control. In order to guarantee transparency in inventory management, a controller may use some performance measures as an inventory turnover or stock-to-sale ratio.

While stabilizing a crisis, a company must defer all planned investment and suspend marketing campaign, participation in trade fairs and trainings. Moreover, a controller should scrutinize carefully fledgling and planned projects.

In times of a crisis a company should not neglect negotiation of better conditions with banks respecting fees, interest rates, credit lines or charges for overdrafts. Large organizations which have several separate bank accounts in different locations may consider combining balances from various accounts and consolidate them in one central account. This strategy is called cash pooling [Szumielewicz 2009]. Such a solution brings some benefits, including: centralized control over cash account, optimal cash return, lower borrowing needs and simple access to funds.

### **3.3. Duties of a controller while implementing cash management rules**

A controller responsible for stabilizing a crisis in an organization is expected to create an effective system of rules which refers to severe cash management control, activities of financial officers responsible for maintaining cash control and operating a system that provides regular reports and projections.

An appropriate system of cash management control depends on several factors, including: a company size, an organizational structure and a type of a business activity.

In small and medium-sized enterprises control system will be centralized. In large companies with complex organizational structures and numerous subsidiaries development of a strategy aiming at improving cash flows will take place at all the levels of a corporate hierarchy. However, strict cash management control in the face of an acute crisis in large companies requires to be maintained at the top level of an organizational hierarchy, alike in the case of SMEs.

A difference lies in the number of people authorized to exert control. In the case of large companies a special team is appointed to maintain control over cash disbursements. Members of this team are empowered to verify and acknowledge each cash transaction and detect errors or embezzlements. Employees placed at lower levels of corporate hierarchy who are in charge of owing debts and settling accounts will be obliged to participate in special daily or weekly meetings. On the one hand, such regular sessions are organized in order to help employees to understand a crisis situation of a company in the face of permanent deficit of financial resources. On the other hand, with these meetings a controller is able to put a constructive pressure on



the internal environment of an organization. It will contribute to change individual behavior, which is necessary to implement a strict cash management. However, a controller has to be prepared for resistance of employees, as well. In such a situation ruthless autocratic attitude may become the only solution.

The last issue is an implementation of a system directed at providing regular and coherent reports and projections. Beside 12-week rolling cash flow projections, a troubled company is supposed to draw up weekly cash performance reports which will compare actual figures with projected data and detect variances and people accountable for them.

### **3.4. The role of a controller in monitoring cash flows**

There are some crucial rules concerning monitoring cash flows. First of all, cash related transactions may take place only after an approval of an authorized person who is empowered to confirm the transaction. Secondly, cash related transactions have to be recorded immediately after each transaction. Thirdly, cash related accounts have to be frequently reviewed and reconciled daily with source documents and finally employees empowered to perform cash related duties should be trained and made to accept their responsibilities.

In conclusion, a company has to maintain an accurate tracking system for cash receiving and disbursing. All transactions ought to be documented and recorded promptly. Documents such as invoices should be kept separately from the place where cash is stored. Duties, including cashiering, accounting, disbursing and collecting cash have to be separated.

## **4. New rules of managerial and financial control in the face of a crisis**

The stabilization of a crisis is connected with an implementation of new principles of managerial and financial control [Slatter, Lovett 2004, pp. 141–143].

First of all, a distressed company should withdraw job offers from the market and stop recruiting new workers. It does not mean, however, that changes in a personnel structure are not possible. If there arises a need to employ a new person, it should be a thoroughly justified decision which is approved and confirmed by the top management.

Secondly, a distressed company ought to freeze salary increases and promotions. Each case should be carefully analyzed and then a decision should be made whether to maintain salary increase or promotion.

Thirdly, if a recovery plan has not been drawn up, all investment outlays should be suspended. All purchase orders with a value exceeding the pre-determined threshold and contracts covering a period longer than one month should be revised and accepted by a controller or a turnaround leader. Moreover, each attempt of a supplier



to increase prices of materials should be rejected. Purchases are to be systematically monitored under close scrutiny respecting: prices, volumes and payment terms.

Internal managerial control ought to be extended over all the contracts signed by a distressed company. An organization in crisis cannot afford to enter a risky contract which, for example, will contribute to a loss of market flexibility. Also selling prices should be monitored. No changes in pricing or in discount systems should be introduced without a consent of a controller. We should know that each poor decision within this framework will be reflected in financial results afterwards.

The last aspect refers to communication with stakeholders. A controller and a turnaround leader are supposed to be prepared for doubts and questions coming from particular interest groups. The problem here is how to deal with a dissent. As it turns out, the best solution is to communicate facts frequently and directly to staff, without allowing interpretation or distortion of a message. No resistance can be tolerated and internal opponents should be swiftly and ruthlessly eliminated. Obviously, this strategy should be applied only while stabilizing a crisis, when there is no time for disputes [Slatter, Lovett, Barlow 2006, p. 110].

Nevertheless, both choosing control methods and communicating them to internal stakeholders should be done with deliberation, but consistently. It is necessary to present facts and justify why a company needs new managerial rules and control methods at the same time.

A distressed company also needs financial control. It is the next step after conservative cash management. A controller is expected to scrutinize whether an accounting system is perfect. First of all, it should be examined if accounting procedures precisely record economic transactions. Secondly, it ought to be checked whether accounting methods guarantee that assets are not overestimated. Thirdly, it should be examined whether accounts definitions are transparent and particular items are recorded on appropriate accounts. And finally, it should be assessed whether periodical financial statements produce an actual picture of an organization's financial position.

## **5. Preliminary cost reduction in the emergency phase of a turnaround**

Preliminary cost reduction is a top-down initiative which can be taken in the emergency phase of a crisis, however, in a limited manner. First of all, efforts should be focused on cash management and adequate financial control. Possibilities for a cost reduction at the stabilization phase of a crisis are rather clear and concern three actions, including: minimizing excessive employment, decreasing purchase costs and trimming overheads. A controller must be sure that staff reduction does not affect adversely a quality of products or services. Reduction or optimization of employment can take place if a sales volume decreases rapidly and a company does

not need as many workers as it required in the past. Cutbacks in overheads should be carried out in reference to the costs which do not contribute to increase in value added and are not connected with cash outflows. These costs may include business trips, conferences, trade fairs or telecommunication expenses.

## 6. Conclusion

The controller's function during the crisis emergency phase may be perceived as the role of a navigator on a ship [Deyhle, Kottbauer, Pasher 2010]. They navigate a set of actions in order to help a turnaround leader to reach a goal of total recovery of an organization. Moreover, they have to face stakeholder's pressure, which very often requires to keep a balance between improvement of short-term cash needs and maintenance of a long-term sustainability of a working capital performance. There are also other issues which derive from a report of KPMG. The research demonstrated that cash flow forecasts which were prepared by companies in time of crisis needed to be more accurate than they had been in fact. The research indicated as well that the best-performing organizations linked working capital performance to managerial incentives [*The Importance of Preserving Cash...* 2008, p. 4]. Another point is that emergency activities described in this paper cannot be perceived as stand-alone strategies which always guarantee recovery from each crisis situation [Sudarsanam, Lai 2001]. The role of a controller during the crisis emergency phase is limited to operational restructuring [Koh, Dai, Chang 2012]. This means that they are responsible for restoring liquidity, first of all, and profitability afterwards by controlling costs, reducing overheads and enhancing efficiency.

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## ROLA CONTROLLERA NA ETAPIE STABILIZACJI KRYZYSU W PRZEDSIĘBIORSTWIE

**Streszczenie:** Artykuł prezentuje rolę controllera na etapie początkowym zaostrego kryzysu w przedsiębiorstwie. W pierwszej części przedstawiono, czym charakteryzuje się faza stabilizacji kryzysu w przedsiębiorstwie oraz jakie zasady obowiązują w trakcie pierwszych działań prewencyjnych. Kolejne części artykułu odnoszą się do obowiązków i zadań controllera. Jego działania w fazie stabilizacji kryzysu opierają się tu na trzech filarach: krótkoterminowym zarządzaniu przepływami pieniężnymi, wprowadzeniu nowych zasad kontroli finansowej oraz zarządczej, a także wstępnej redukcji wybranych pozycji kosztów.

**Słowa kluczowe:** stabilizacja kryzysu, krótkoterminowe zarządzanie przepływami pieniężnymi, kontrola zarządcza i finansowa.