Chartered Institute of
Management Accountants

Experiencing change in German controlling: management accounting in a globalising world

Research executive summaries series

Vol 5, Issue 12

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ISSN 1744-7038 (online)
ISSN 1744 – 702X (print)

Acknowledgment

The researchers would like to thank CIMA for funding this project.

Overview of project

This report considers contemporary practices of German 'controlling' – a term which is usually translated into English as 'management accounting'. The research was conducted in three case study manufacturing organisations in Germany – one a large private company, the second a division of an international group and the third a family firm. It examined the management accounting systems of these companies and their relationship with the companies' competitive strategies, organisational structures, computerised information systems and external reporting.

The research highlighted some key differences between German controlling and UK management accountancy practice. The profession has developed differently in Germany, with quite different education and training for controllers, and an absence of a professional body equivalent to CIMA, the Chartered Institute of Management Accountants. As a result, there is some variation in the use of techniques and terminology. The challenges for UK practitioners trying to understand such differences may be compounded by language differences when terms are translated between German and English. Some examples of this were identified in the research.

In addition, the research found that the German case study organisations placed great emphasis on financial figures in their management information packs. Relatively little attention was paid to non-financial indicators by senior managers. The research also highlighted interesting differences in terms of budgeting and forecasting, and in relation to cost allocation. The German companies placed less emphasis on variance analysis and interpretation than might be expected in similar UK companies. We found an emphasis on forecast costs but less on product cost outcomes, and a relatively low level of reliance on intra-company profitability analyses. Financial information was used to control (bear down on) costs and to monitor process efficiency, but evaluating business units and managers, or monitoring the profit margins of individual product lines, was significantly less important.

As well as revealing some of the characteristics of German controlling, the research points to some of the changes being experienced by German manufacturing companies and by those working in the management accounting (controlling) field. This report provides a resource for CIMA members and other UK management accountants who have connections with German companies and/or wish to learn from German practices. It also provides an insight into the influence of national characteristics and processes of globalisation on the development of management accounting.

1. Objectives

The research sought to:

- examine the experiences and interpretations of controllers and managers in three German case study manufacturing companies
- investigate the management accounting systems of these companies and their relationship with the companies' competitive strategies, organisational structures, computerised information systems and external reporting
- explore the extent to which contemporary controlling represents a distinctive, specifically German, contribution to the management of companies or conversely, it demonstrates more generic international practices
- contribute to the debate on the influence of national characteristics and processes of globalisation on the development of management accounting
- provide a resource to non-German accountants and managers who have an interest in German management accounting practices.

2. Research approach

Three German manufacturing companies were chosen to provide different organisational forms:

- CarAccessories - a large private company
- PowerComponents - a division of an international group; and
- StorageSolutions - a family firm.

More detail on the case study organisations is in the appendix. All three companies had been confronted with some form of trading or financial crisis and consequent organisational change in the past decade. The crises had triggered organisational change - to improve sales and production processes through the greater focus and clarity of goals provided by a business unit structure – and also accompanying accounting change - attributing more power and importance to accounting and connecting it to performance management systems.

The changed focus and structure of the companies had in all three cases been supported and made visible by their accounting report formats and accounting based managerial bonus systems. It was evident that they had all been engaged in a process of change from prior production or operational focus to a new focus directly on returns to capital, and a concentration on customer service and financial performance measures.

Interviews were conducted in each of the three case study organisations with managers responsible for management accounting (controlling), financial accounting, production and marketing. Accounting documents and other company specific material from each organisation were also examined. The research also included a review of existing literature on international and inter-cultural differences and similarities in management accounting, which revealed outsider perspectives on the traditional German approach.

3. Main findings

3.1 Professional practice

German controlling has developed differently from UK management accounting, and represents an alternative tradition to the British approach familiar to CIMA members. There is seldom anyone who would be labelled as a (or the) management accountant in German companies. A key difference between UK and Germany relates to the English language use of the terms ‘management accounting’ and ‘management accountant’ versus the German terms ‘controlling’ and ‘controller’. There is certainly overlap between the techniques and functions of management accounting in the UK and those carried out by a controller in Germany, but it is not complete. The professional organisation of management accounting in Germany has not developed in the same way as the UK and there is, for example, not an equivalent to the Chartered Institute of Management Accountants. Instead, the education and training of controllers has developed differently. In Germany, the universities, rather than professional bodies, have had the greatest influence on setting the theoretical foundations of the discipline. This has, in part, meant an absence of standardised practices and interpretation of accounting terms. Some examples of differing approaches and interpretations were found in our case studies, and are discussed below.

3.2 Management information

Each company had recently introduced new performance indicators and management incentive schemes. These innovations were explained by managers as a response to new organisational structures (see below). The formal routine management information packs for senior managers at all three companies were almost exclusively based on financial figures. We were assured that many important facts and trends were generally known by managers but not reported. At CarAccessories, the apparent centre of attention in the monthly information pack is a set of pictorial summary indicators of sales, contribution, EBIT, production expense, working capital and, finally, employee numbers; with only one of these ‘pictures’ representing non-financial performance. Similarly at StorageSolutions non-financial figures or information are apparently given much less attention at formal meetings than the financial measures. Generally, non-financial performance statistics tend to come not through the controller but through the operating units. This contrasts with the ‘ownership’ and delivery of such data by ‘management accounting’ in many UK companies.

3.3 Costing and overhead allocation

We found that the companies placed an emphasis on using financial information for controlling (bearing down on) costs and monitoring of process efficiency. Management accounting for evaluating and motivating the business units or managers and monitoring the profit margins of individual product lines seemed significantly less important. Managers were aware of the imprecision of the monetary costing of their production but conveyed indifference, partly because financial figures relating to product, customer and cost centre profitability are either not available or are not seen as critical to the way the business is run. A lack of ‘angst’ about overhead allocation was a striking feature at all three German companies. At CarAccessories, research and development, and even some controlling, is devolved down to business unit level. Similarly, at StorageSolutions, the costs of design are not seen as centralised overheads as they would be in the UK but direct costs in respect of business units and product lines. At PowerComponents the overall profit or loss, rather than the figures for individual business units, was the most important item when considering performance at monthly meetings. Despite the rhetoric (and formal organisational structures) relating to accounting evaluations of business units, the lack of concern about cost allocation and the basing of bonuses on overall (rather than business unit) results implied the absence of a whole hearted 'buy-in' to financial control systems.

3.4 Budgeting and forecasting

We found that the German companies placed less stress on the use of variance analysis and interpretation than might be expected in similar companies in the UK. There was emphasis on forecast costs but less on product (or product line) cost outcomes, and also a relatively low level of reliance on intra-company profitability analyses. On the other hand forecasts of various types are clearly very important management tools. At CarAccessories financial and operational forecasts are prepared for up to ten years ahead. Each year there is also a whole year forecast that starts off as the budget but is then updated as each month goes by based on revised expectations. In addition, there are several other budgets, forecasts and targets but, significantly, these are supplementary tools rather than being integrated into the financial performance reports. Our overall impression was that budgets are particularly important as forecast tools and to assist planning, but they are less used in a sophisticated way for monitoring and control.

3.5 Terminology confusion

The research demonstrated that great care needs to be taken by English speakers when interpreting financial reports in Germany. The same technical words (and words which translate directly into English) such as 'direct expenses', 'contribution', 'depreciation' and 'EBIT' are used to represent different concepts. Some of the examples we found included:

- an income statement line item described as 'direct overhead expenses' with direct expenses containing overheads such as managerial salaries
- a sub-heading 'contribution' that is definitely not revenue less variable costs (as it would be in Anglophone systems) but something more like 'margin'
- variable cost variances based on unflexed budgets
- 'EBIT' (technically an acronym for earnings before interest and tax) that was actually calculated after interest costs.

Other words and phrases that have significantly different interpretations or applications are standard costing, depreciation, performance, balanced scorecard, activity based costing, design and contribution. As well as variation between the German and Anglophone systems, we found evidence of variations of interpretation within Germany. To some extent the precise interpretation of an accounting term can depend upon where an individual studied and the traditions of the companies in which he or she has worked.

3.6 German controlling and change

All of the companies included in the research were experiencing change, and this was reflected in the changes facing the controllers, accountants and managers that we interviewed. According to the academic literature, the traditional German model of controlling is characterised by:

- a separation of cost and management accounting from financial accounting
- a separation of controlling from operations
- controllers acting as co-ordinators, rather than as members of management.

The research case studies confirmed some of these expectations but also departed from the model in significant ways. The delineations between controlling and accounting are being blurred by apparently more transparent financial accounting under International Financial Reporting Standards (IFRS). Also, operational managers indicated that, wherever it comes from, financial information is increasingly integrated into corporate rhetoric and planning. They are experiencing a move away from the traditional mode of 'technical management' of production to a more 'entrepreneurial' management of profit centre business units that relies more heavily on financial information. Our findings suggest that controlling is more complex than suggested in the literature, and that it is changing.

The controllers, accountants and managers that we interviewed were keenly aware of change. The changes they experienced were not the adoption of new international management accounting techniques. In fact, traditional German practices such as imputed costs, intense use of cost centres, contribution margin statements and so on, remain important. Instead, the changes being experienced in the three case study organisations relate to the changing economic context of their companies, linked to international globalisation. These trends have triggered organisational change in which traditional functional departments have been replaced by a business unit form of organisation. A 'technical', production oriented management style has shifted to a more 'entrepreneurial', customer facing approach that places managers at the head of profit centres. As a result, management information has changed from an emphasis on non-financial, physical information (owned by technical specialists) to a focus on financial information (supplied by the controlling department) – in particular in relation to key performance indicators. In each company this new emphasis on financial key performance indicators was reinforced by the introduction of incentive bonus systems based upon them. In CarComponents it was a two tier system in which all staff were rewarded according to financial performance with an additional responsibility bonus for senior management; in PowerComponents bonuses for managerial staff were based on EBITDA, value of sales, and holding working capital levels low; and in StorageSolutions managers were rewarded by bonus based on the net profit of business units.

4. Implications for practitioners

CIMA members may benefit from an awareness of some of the differences between German controlling and UK management accounting, particularly in dealings with German companies. As already highlighted, German controlling represents a quite different tradition to the British approach to management accounting that CIMA members will be familiar with. German controllers have different education and training, different theoretical foundations and practices of management accounting, and stand in different relationships to financial accounting and to management when compared with their British counterparts.

As well as an awareness of these cultural differences, CIMA members doing business with (or contemplating doing business with) German companies will find it valuable to note some of the potential confusions that can arise from differing uses of language and terminology. Some of the words and phrases that could potentially cause confusion have been highlighted in the research. In describing some of the different interpretations of words that translate into English concepts we are not, in any way, implying that German concepts are wrong, invalid or lacking in usefulness. The important point is the danger that arises from uninformed outsiders assuming that German concepts translated into familiar English terms mean the same as what those English terms normally mean.

5. Conclusions

German controlling has developed in very different ways to management accounting in the UK, and our research in three German manufacturing companies identified some examples of this. The different education and training of German controllers, and the absence of a CIMA style professional body can result in variations in management accounting practices and interpretations. Potential confusion can arise when translating management accounting terminology from German to English, and English speaking accountants should take care when interpreting financial reports in German companies.

Each of the three case study organisations had experienced a crisis in the past decade. In CarComponents it was a change from family to professional management; in PowerComponents it was a change of ownership; and in StorageSolutions it was a profit squeeze. These were seen by our respondents as the catalysts for widespread changes leading to an adaptation of a traditional German pattern of managing. In all cases the traditional form was replaced with business unit organisation, customer orientation, use of key performance measures, and managerial incentive systems linked to these. These changes were seen as leading to increasing importance of financial management accounting information provided by the controlling department. It may be that in companies that have not experienced such a crisis no such transformations have taken place. However, it is generally true that the years of the late 20th and early 21st centuries were difficult ones for German manufacturing and this suggests that many companies will have experienced their own crisis of some form. In the face of these, they are likely to have drawn upon current notions of 'best practice' in international management discourse. Like the companies in our case studies, they are likely to have introduced business unit organisation, customer orientation, key performance measures and managerial incentive systems.

Our research into the management accounting features of the three case study companies found examples of German controlling practice that is distinct from UK management accounting. However it also revealed examples of the change being experienced within the companies and in their controlling practices. While some techniques of management accounting practised by the controllers in our three companies remain distinctively German the functions of controlling and the roles of controllers are moving in directions that will be more familiar to management accountants in the UK and other Anglophone countries.

Appendix: The case studies

PowerComponents is a division of a German group. This group had been a subsidiary of a German holding company until it was taken over by a US venture capitalist some three to four years earlier. It produces high technology capital items in Germany with some labour intensive activities outsourced to a Serbian subsidiary and an associate company in the Czech Republic. Its customers are huge transnational corporations across the globe, and it maintains a sales subsidiary in the USA and sales agents across Europe. Its competitors are 'global players' including two multinationals based in Germany, two in the UK and one in Brazil.

StorageSolutions is a small company under the ownership of a single family, with long standing capital support from a local bank (that recently became part of a transnational finance group), and run by the only active family member. It produces two lines of high technology products and has a third service and parts department. The family also owns a production plant in Hungary which, although legally separate, operates very much as a sibling company to the Bavarian firm. Of its 300-400 customers around 95% are German owned and vary in size but many of them are very much larger than itself and employ StorageSolutions' products in factories around the world. In one product the majority of its competitors are German (and the company seeks to maintain its position in the top five in the country); in the other product the competition is with German, British and Italian firms (and it seeks to be in the top three in Europe).

CarAccessories is a large family owned firm with no long-term debt. It produces in three plants in Germany and in a UK subsidiary company. It manufactures components to the automobile industry that have a high R&D and engineering content. Its main customers are the global automobile manufacturers but there is some additional business in selling the same products through the retail market. Although small in relation to its customers, CarAccessories is the largest of the four companies operating in this global market; the others being one Dutch, one American and one Japanese.