Strategic Financial Management and its Information Support in the Czech Republic (Empirical Study)#

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Preface

Specialists recently discuss increasing importance of companies' strategic management as one of the important indicators of their long term prosperity. (Kaplan – Norton, 1996; Brandon – Drtina, 1996; Král, 2006; Šoljaková, 2003). This research focuses on application of the methods and tools of the strategic financial management and its information support in the Czech Republic. This country has gone through large economic transformation from central planned to modern market economy in the last 15 years.

Methodology

This empirical research came from the results of the benchmarking research project "Business Navigation" that was undertaken under the Point Consulting, Ltd., Prague coordination in 2003-2005 and in which members of Management accounting department of the University of Economics, Prague with the specialists of the Czech Technical University, Prague and Inekon Systems, Ltd. Prague participated.[1] 148 large and me-

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1 More detailed information about the outcomes of this research – see (Point Consulting, 2005).

dium companies operating in the Czech and Slovak Republics accepted invitation to supply researchers with information from two areas:

- business environment and evaluation of management processes quality, and
- evaluation of quality of instruments of managerial control.

One of the important outcomes of the research was the fact that respondents of many companies operating in the Czech and Slovak Republic admitted that they focused on the management in the relatively short tactic and operational horizon. Their management is then closely connected mainly with respect to the impact on financial criteria (in particular profit, EVA, return on equity and return on investment – including their modifications). This orientation is often supported by the owners of the enterprise and by those who state macroeconomic rules of undertaking – without their ability to recognize that their stress on tactic financial results may decrease ability of the companies to successfully develop themselves in the long-term horizon. Although there was substantial difference in those tendencies in the Czech owned companies and companies owned by a foreigner owner[2] the extent of this orientation lead to conclusion to start preparation of a project that would investigate the quality of strategic company management including its information support. The project was started at the end of 2003.

Research is based on direct investigation of actual situation in the Czech Republic. The questionnaire was developed and then sent to 72 top managers (Chief Executive Officers and Chief Financial Officers) of those companies who were willing to collaborate. Regarding sample of companies, we have limited selection to the companies with more than 100 employees and with turnover more than 25 million USD. After certain time the managers had to think of the answers they were interviewed by the members and PhD students of the Management accounting department so that we got reliable and comparable information. The second reason of the individual interviews was to clarify content, structure and

[2] For example – statement “top management believes that exclusively financial aims are the best incentives for managers and employees” supported respondents of 48 % Czech owned companies and 29 % respondents from companies controlled by a foreigner capital, statement “there is no problem for us to shift expenses/revenues/profit from one time period to another so that we get bonuses derived from financial targets” supported respondents of 47 % Czech owned companies and 30 % from companies controlled by a foreigner capital.

wording of the questionnaire for the second stage of the research – to distribute it electronically to participants of the preceding research and other companies willing to collaborate.

Final intension of researchers is to undertake harmonized research that would investigate the subject of research not only in the Czech and Slovak Republics but also in other countries which accessed European Union in May 2005. One of such activities has been already started: it is our collaboration with the International Performance Research Institute where we harmonized the aim, content and structure of the questionnaire with the representatives of newly accessed countries and now we are preparing a sample of companies which will be addressed electronically.

Contents and structure of research

After initial data enabling a company classification, the questionnaire is structured into three parts:

- the first part focuses on application of strategic management in businesses:
  - who is responsible for business strategy formulation (owners or management);
  - what concrete actions companies executed in connection with strategic management support;
  - what tools and methods of strategic management companies apply;
  - what are the main indicators of strategic development; and
  - what are the main measures of strategic company performance.
- the second part is oriented on implementing and control phase of strategic management:
- what the quality and integrative role of strategic plans and budgets;
  - what are the impulsions of investment decisions, how they are analyzed and to what extend they are integrated with the system of strategic plans and budgets; and

- what is the structure and volume of the long term capital and what are the impulsions of its changes.

▪ the last third part focuses on information support of strategic financial management:

- what is the principle conceptions and orientations of management information system;
- how companies' performance is measured;
- to what extend companies use tools and methods of strategic management accounting; and
- how information technology supports the integrative role of information tools in strategic company management.

Strategic management

The answers to questions stated in the questionnaire and also following discussions confirm that the establishing of the explicit missions and goals and their effective communication through companies is considered the necessary conditions for their long term development and prosperity.

Strategic missions and goals setting depend on following factors:

- **Owners:** generally said, enterprises belonging to multinational firms have better level of setting missions and goals than Czech companies – the only one exception is the situation when CEO is also owner/one of the substantial owners of the company.[3] Setting and communicating strategic missions and goals is – on the other hand – very poor in state owned and semi-state owned companies.

- **Character of business activities:** companies providing research and development activities and operating in capital-intensive branches have more developed system of strategic management including mission statement and its communication.

[3] This finding is compatible with the outcomes or the preceding research. The statement "All our employees are fully identified with our clearly formulated vision" supported 78 % of managers of companies owned by a foreigner capital, but only 38 % of managers (non-owners) of companies owned by Czech owner. Also the statement "Our strategy does not disappear as managers devote it adequate, first row attention" supported 57 % of managers of companies owned by a foreigner capital, but only 36 % of managers (non-owners) of companies owned by Czech owner.

- **Pressure of competition:** some companies introduce changes to create specific strategic core competencies either to survive either to get competitive advantage. This aspect has been very much stressed. The change processes can be classified into the following classes:

    - **Reordering:** the process that alters the role of some core competencies and upgrades peripheral routines;
    - **Venturing:** flexible units of competencies are organized separately and have substantial autonomy;
    - **Restructuring:** exploration of capabilities takes place at the corporate-management level while the exploitation takes place at the business-unit level (top-down process);
    - **Revitalizing:** the process that alters a core competence to something the organization does not currently possess;
    - **Reanimating:** change is made through originating, developing, and promoting strategic initiatives from the lower levels of the organization;
    - **Rejuvenating:** wholly new processes are implemented so they substitute for outdated routines and capabilities.

    According to the respondents, the general aims of these changes are

    - to eliminate activities that are – from strategic viewpoint – non value added;
    - to outsource (especially service) activities, especially in the cases they are cost demanding in comparison with market prices;
    - to focus on production of new products, acquisition of a new markets segment, development of new distribution channel or implementation of a new technology.

All above stated changes have immediate impact on the organization structure of companies.

These strategic changes are accomplished above all in enterprises that their majority owner was changed during the last 3 years (89 %). Only 22 % of the companies with no changes in majority owner during the last 3 years accomplished the strategic changes.

Interesting, but also compatible with growing competition[4] is the survey of principle factors that lead company managers to strategic changes (see Table 1).

Tab. 1: What are the aims of strategic changes?

Reason of changes	Percentage of companies
Cost reduction	80
Profitability increasing	75
Modernization of technology	62
Customers and public relation	61
Improvement of information technology and system	42
Transparency of processes	40
Utility qualification of employee	35
Improvement of working and social conditions	18
Legislation requirements	12

Setting mission and formulating strategy require analyzing the external and internal environment. According to respondents, these analyses are mainly based on SWOT analysis and Value change analysis. Their principle purpose is to identify factors which could bring comparative advantages and indicators of positive strategic development (see Table 2).

Tab. 2: What factors do you consider for the strengths and weaknesses?

Factor	Strengths Percentage of companies	Weaknesses Percentage of companies
Prices of products (outputs)	80	20
Prices of raw material	42	58

[4] Growing competition and its intensity perceived by managers was the subject of preceding research. 94 % managers was convinced that the pressure on prices is constantly growing, 67 % of managers perceive growing speed of innovations and shorter life-cycles of products, 63 % of managers supported the statement "Market is influenced by changes which are very difficult to forecast".

Factor	**Strengths** **Percentage of companies**	**Weaknesses** **Percentage of companies**
Labour costs	72	28
Capital adequacy ratio	38	62
Technology	40	60
Research and development	31	69
Images	64	36
Quality of products	52	48
Qualification of employee	55	45

As visible from the table, managers perceive products´ prices and corresponding low labour costs (especially in relation to skills and experience of companies' employees) as the strongest strengths of this time period; on the other hand they feel their main weakness in poor efficiency of their innovative activities.

Setting strengths and weakness continues with identification of threats and opportunities. Preventing of threats, that is turning them to opportunities, will be carefully analyzed as a strategy for each main activity separately. Strategic positioning is composed of a matrix including prioritized threats (in order of importance) as columns and the main activities of the company as rows. On the basis of this strategic activity matrix the strategy for the whole company will be selected. This strategy is selected under uncertainty, because the probabilities of the threats are usually not known.

Tab. 3: What are the most important indicators of strategic development?

Indicator	**Percentage of companies**
Acquisition of customers	100
Customer retention, satisfaction and loyalty	95
Quality of product	92
On-time delivery	89
Cost of products and processes	88

Indicator	Percentage of companies
Operation and flexibility of processes	74
Development of new product	70
Employee satisfaction and retention	49
Employment qualification	45
Innovation of technology	44
Information system and technology	40

This research clearly shows that the most important indicators concerns with customer relationship and public relation. On the other hand – employee satisfaction and generally human resources strategic management are still undervalued by most of respondents. According to our opinion it is one of the transitional consequences and we suppose the advancement in these perspectives.

Measures of strategic performance

Regarding strategic performance measurement, the research has been concentrated on typical structure of financial measures with two basic questions to respondents:

- Which of them do you use in your company; and
- Which of them do you consider to be the most appropriate to reflect your company strategic targets?

The answers are stated in the following Table 4.

Tab. 4: Strategic performance measurement

Measures	Measured Percentage of companies	Viewed as appropriate Percentage of companies
EBIT	52	25
Profit after Taxation	100	28
Return on Assets	55	72
Return on Equity	45	75

Measures	Measured Percentage of companies	Viewed as appropriate Percentage of companies
Residual Income / Economic Value Added	61	80
Market Value Added	10	12
Market price of shares	5	7

When comparing the responses to both questions the significant inconsistency is visible: the most of managers and companies use absolute profit measures but they are convinced that ratio measures like returns on assets or equity should be more appropriate for the company strategic orientation. What is also apparent it is companies' increasing interests in measures based on residual income basis. Finally, interesting, but in the recent stage of the market development quite natural – is managers´ disbelief to marked oriented measures.

Implementing and control phase of strategic management

System of plans and budgets

Regarding the second part of questionnaire dealing with implementing and control phase of strategic management, plans and budgets are considered to be the most important tool of implementation strategy according to the majority of respondents. In their opinion, the most important issues influencing the quality of these phases as well as values of system of plans and budgets are connected with the strategic plans and budgets transformation into the tactical and operational levels, with translation of strategic criteria of the company as a whole to middle and lower management levels (with the main stress to assure responsibility aspects of translation – it means consistency of company and responsibility centres interests, controllability and motivational efficiency of this translation) and – consequently – the level of their integration to employees´ stimulation and compensation system.

The basic budgets are ordinarily set to cover a one-year period. This one-year period corresponds usually to the companies' fiscal year. Nevertheless, most of the interviewed companies divide – relatively correctly in relation to their capacity utilization – their year plans and budgets into quarters and months. System of long-term plans and budgets are prepared partly in industries with long-term business cycle, companies operating in high capital intensive branches and hi-tech companies. The tendency is visible that the enterprises with better level of plans and budgets:

- belong to multinational firm;
- have high capital requirements;
- have strong research and development activities and
- have a long-term business cycle.

Summary of the time horizon of the processing plans and budgets is shown in Table 5.

Tab. 5: Time horizon of the processing system of plans and budgets

Period of preparing and analysing plans and budgets	Percentage of companies
Monthly	77
Quarterly	68
Yearly	82
Interval 2-5 years	48
Interval 5 and more years	12

This part of research also focused on type of plans and budgets and methods used in their development (see Tables 6 and 7). The rate of progressive methods used in the preparation and usage of the system was very surprising – in the positive sense of the word; although the preceding research indicated strong shift in positive understanding of benefit of plans and budgets,[5] role of plans and budgets was strongly refused still in the middle of nineties as the consequence of negative role of the whole system in the conditions of central planned economy (Král, 2006; Fibírová – Šoljaková, 2005).

[5] 70 % of managers supported the statement “The benefits of plans and budgets are higher than energy/capacity/costs expended on their development.”

Tab. 6: Usage of flexible and rolling budgets

Type of Budgets	Percentage of companies
Rolling budgets	57
Flexible budgets	32

Tab. 7: How to set the budgets?

Methods	Percentage of companies
Adjusted actual information from the last period[6]	44
Zero-based budgeting	9
Combination of both	51

Capital investment decisions

According to respondents most of them make their capital investments decision on the basis of financial criteria used for assessment of investments. Only 12 % of the companies do not use financial criteria for assessment of investments, they prefer order of necessity. The rest of 88 % of the companies use traditional criteria and methods; the rate of application is shown in Table 8.

Tab. 8: Financial criteria usage for investment decision-making

Criterion	Percentage of the companies using criterion
Net present value	87
Internal rate of return	47
Profitability index	52
Payback method	94
Accounting rate of return	38

[6] Adjustments include especially supposed changes in extend of activities, exclusion of unusual events etc.

Optimizing of capital structure is still not very developed issue. Decision making is often very limited due to the "automatic" loans from mother companies (in the cases of companies owned by a foreigner capital) and in other cases concentrates on choosing between financial leasing and bank credit. The main reason is that capital markets are not fully developed in the Czech Republic, and therefore it is quite extraordinary to call for capital by issuance and distribution of shares or bonds. From two above stated "usual" forms companies prefer financial leasing to credit; financial leasing is more available, more convenient for tax purposes and – more over – according to the Czech accounting standards financial leasing is reported as operating leasing, so it does not increase debts in disclosed in the balance sheet.

The consequence of these facts is that 81 % of respondents state their companies do not struggle for long term optimization of cost of capital. They only calculate costs of capital by individual decisions through monitoring of interest rates and credit conditions, tax benefits and comparing leasing and credit financing. Only 19 % of the companies struggle for long-term and complex optimization of capital structure.

Information support

Czech financial accounting standards have been under state regulation and they are focused on fiscal interests for a long time. This was the reason why one of the research aims was to ascertain how companies use the possibility of different way of recognition, valuation and disclosure (reporting) of assets, equity, liabilities, income, expenses and profit reporting in financial and management accounting. 62 % of companies have no significant differences between financial and management accounting. Nevertheless, surprisingly high rest of companies has (or calculate with) different results in management and financial accounting.[7] The reasons are shown in Table 9.

[7] It is necessary to stress that some of these differentiations are not fully integrated into the accounting system (into the books) but they are taken into the consideration in the calculations for managers (especially for costing purposes).

Tab. 9: Incorporation of the dual concept of financial and management accounting

Item	Percentage of companies
Imputed interests	33
Imputed depreciations	14
Imputed rent	2
Recognition of leased assets as fixed assets in balance sheet	41
Valuation variances of stocks	35
Valuation variances of fixed assets	14
Recognition of intangible assets (R&D, strategic marketing) in balance sheet	8

Management accounting systems are oriented above all on costing of the final product (project, orders) and measurement of contribution (profit, margin) of products and customers (see Table 10). Moreover, timeliness and variance analysis of actual and budgeted values are considered to be very important benefit of management accounting.[8]

Tab. 10: In which way is the management accounting system orientated

Item	Percentage of companies
Costing of final products (orders)	96
Responsibility variance analysis of actual and budgeted figures	60
Measurement of contribution of products	92
Measurement of contribution of customers	44
Measurement of contribution of distribution channels	36

[8] Many world-wide operating companies (including Czech subsidiaries) require elaborating their month reports two or three days after the evaluating period; year reports (currently linked up with audited financial statements) are submitted up to one week after the end of calendar or business year.

Item	Percentage of companies
Measurement of contribution of sales representatives	28
Regions of sales	19

One of the main goals of this part of research was to find out level of implementation and support of innovative and modern methods of strategic management and strategic management accounting (Johnson – Kaplan, 1987; Kaplan – Atkinson, 2005; Král, 2006; Šoljaková, 2003). The questions which should help to know more about the issue started with the list of the methods and were formulated as follows:

a) Do you apply these methods in your company? Or.
b) Do you consider their application in your company? Or.
c) Do you think their application would bring benefits to your company?

The result of this investigation is stated in Table 11.

Tab. 11: Usage of innovative methods of (strategic) management accounting

Methods	Applied Percentage of companies	Considered Percentage of companies	Benefited Percentage of companies
Balanced Scorecard	52	14	3
Life Cycle Costing	15	3	–
Target Costing	17	7	–
Activity Based Costing	22	18	22
Activity Based Management	14	15	25
Activity based Budgeting, Zero based Budgeting	5	10	4
Value Based Management	8	35	22
Value Chain Analysis	8	35	26
Customer Profitability Management, Customer Profitability Analysis	33	40	20

Methods	Applied Percentage of companies	Considered Percentage of companies	Benefited Percentage of companies
Time Based Management	20	18	4
Total Quality Management	55	21	10

Conclusions and Summary

The study focuses on strategic management (SM) quality in the Czech Republic. The empirical research based on questionnaire and discussion with CEO and CFO was implemented. It involves three parts.

The first part focuses on principle features with stress on questions: who is responsible for business strategy, what its tools and methods companies apply and what strategic development indicators they use. Research confirms that establishing of explicit missions is substantial condition for long term prosperity. The most important indicators are deemed customer satisfaction and products' quality. Low labour costs in relation to the employees´ skills and experience are counted significant strength in relation to foreigner competition.

The second part was oriented on implementing phase of SM. Plans and budgets are considered the most important tool of implementation strategy. Also ability to translate their targets into shorter time and lower responsibility levels and their integration with stimulation system was stressed. Higher level of implementation was found in multinational companies.

Last part focused on information support of SM. Information systems are oriented above all on final product costing, responsibility centres and customers´ contributions. Timeliness is considered important value of management accounting. There is positive tendency that Czech companies exert to implement innovative methods of strategic management accounting. They prefer customer oriented tools; conversely – they do not believe to benefits of AB methods.

Generally said, the implementation and usage of strategic management tools and methods including strategic management accounting have been increasing from the beginning of the 21st century. The research has not investigated reasons of this positive tendency but quite apparently they are two important aspects which could have their impact on it:

a) growing importance of strategic management that is accompanied by better understanding and knowledge of strategic management tools and methods among managers; this tendency is also strengthened by better IS/ICT support;
b) great development of investments to the Czech Republic and their change from "manufacture" branches to branches with higher research and development potential.

Their impact on strategic financial management development will be the subject of a future research.

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The first part focuses on principle features with stress on questions: who is responsible for business strategy, what its tools and methods companies apply and what strategic development indicators they use. Research confirms that establishing of explicit missions is substantial condition for long term prosperity. The most important indicators are deemed customer satisfaction and products´ quality. Low labour costs are considered to be significant strength in relation to foreigner competition.

The second part was oriented on implementing phase of Strategic Management. Plans and budgets are considered the most important tool of implementation strategy. Also ability to translate their targets into shorter time and lower responsibility levels and their integration with stimulation system was stressed. Higher level of implementation was found in multinational companies.

Last part focused on information support of Strategic Management. Information systems are oriented above all on final product costing, responsibility centres and customers' contributions. Timeliness is considered important value of management accounting. There is positive tendency that Czech companies exert to implement innovative methods of strategic management accounting. They prefer customer oriented tools; conversely – they do not believe to benefits of AB methods.

Key words: Business Strategy; Performance Measurement; Strategic Management Accounting Tools and Methods; Indicators of Strategic Development.

JEL classification: M40.