



**Dear readers**

In 2016 there were about 282,000 commercial start-ups in Germany, according to Institut für Mittelstandsforschung (IfM) Bonn, a foundation dedicated to research on small and medium-sized companies. The idea of a garage-start-up in a Steve-Jobs manner and with modern flair is tempting. In the resulting euphoria, however, most founders neglect the topic of controlling, either partially or even completely. Yet both the short phases of their life cycle and the explosive growth of young companies make the topic of controlling for start-ups all the more urgent. Even established companies have been increasingly launching their own start-up initiatives in recent years (e.g. innovation labs, accelerators, incubators, hubs and corporate venture capital), of course without having any experience in controlling them. The thematic priority resulting for the ICV Think Tank – **Controlling of Start-Ups and Start-Up Initiatives** – is limited in this Quarterly to the special requirements of controlling in start-ups. The following editions will then focus primarily on the controlling of start-up initiatives in established companies. Hopefully you are already looking forward to the next Quarterly!

We wish you enjoyable reading.

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**Reading tips**

The book **Kooperationen zwischen Mittelstand und Start-Up-Unternehmen** (Partnerships between SMEs and Start-Up Companies), by W. Becker & P. Ulrich (editors), offers an initial insight into the world of corporate partnerships. It focuses on start-up companies, which have become an important success factor for the small and medium-sized business sector. The authors present the findings of a survey they conducted among 102 companies, and include in their analysis a case study with 24 companies. They conclude by deriving recommendations for action and best practices.



In his book **Controlling in Start-Up-Unternehmen** (Controlling in Start-Up Companies), Jürgen Diehm provides founders with useful tips to help them obtain meaningful management and decision information. A gradual build-up of a separate controlling unit can be a significant challenge for founders, especially for those without a business-related background. Besides tips and examples, the book also provides the reader with useful checklists.



## Management control systems in start-ups | Form depends on life cycle

Due to the special characteristics of start-ups, common management control systems cannot be simply transferred to these companies. The appropriate control mechanisms must first be adapted to start-ups.

Until now, **management control systems (MCS)** in start-ups have received very little attention in academic research. In principle, MCS offer the controller a wide variety of tools (including communicating objectives to stakeholders, balancing stakeholders' interests) that help management to align a company with its **strategic objectives**. The realisation of **competitive advantages** is the priority in this regard. Managers can use MCS to implement planned strategies more efficiently. Frequently, MCS are also seen as an interface between performance measurement, resource allocation as well as communication and coordination. Decision-makers, however, usually do not place a great deal of value on the implementation of MCS, particularly in young companies.

Lycko & Mahlendorf investigated in 2017 why MCS tend to receive less attention in start-ups than in established companies or groups. They determined that controlling must often be adapted to the individual phases of the **life cycle process** (see Figure 1), and that the duration of the respective timeframes is not predefined. In most cases, the **foundation** begins with a relatively small team (e.g. only the founder, friends or family) and the available resources are limited. For this reason, a detailed formalisation of MCS in this phase does not appear useful. As a result, **cultural control mechanisms** prevail here to influence the behaviour of employees based on shared perceptions, norms and values.

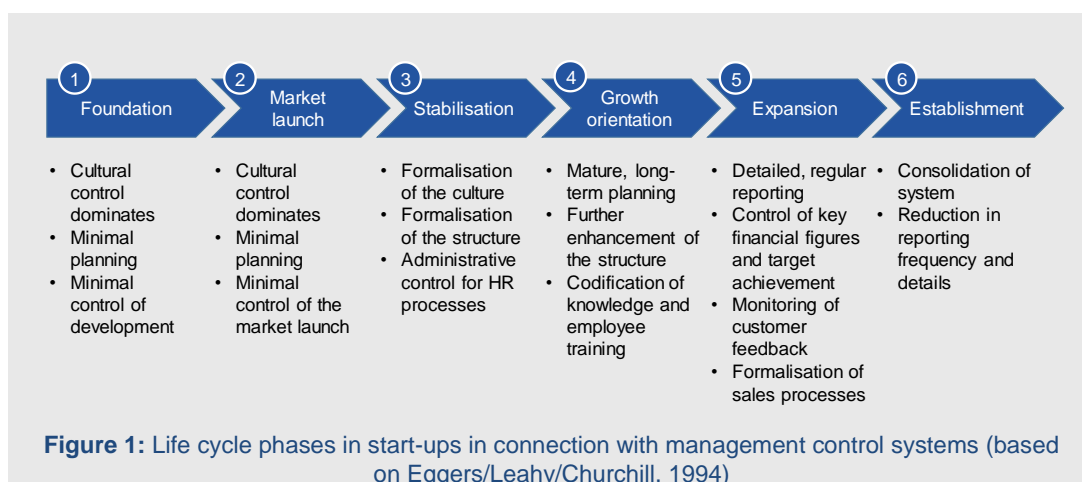
After the foundation, start-ups initially want to gain customers. Then they optimise their product and service offering based on these initial customer relationships. The uncertainty about suc-

cess and the product limits any long-term planning. Nevertheless, the start-up in this phase already begins to perceive **customer requirements**, which through feedback must be incorporated into the product. Due to the initially small number of customers and the possibly risky nature of the decision to purchase the product, a high degree of formalisation here also appears to be an overly complex organisational task, one that would generate more costs than benefits.

In the **stabilisation** phase, the product has proven itself to be feasible, both technically and commercially. The start-up must hire new employees, solve problems and make processes more efficient. Together with them, both the culture and the structure of the company are specified.

Now the start-up would like to grow. Successful **scaling-up**, however, requires more than just obtaining (new) investors; processes must be **formalised** too: investors often demand reporting covering short periods of time. The growth of the start-up also significantly increases its **complexity**. This increase, though, can be anticipated by a high **level of formalisation**. At this point, **liquidity** should also be highlighted as a **bottleneck**. During the expansion, the MCS will probably reach their highest level of complexity to date. The introduction of key performance indicators (systems) to calculate profitability or **customer acquisition costs** is indispensable. Further customer feedback should also help to optimise the product for the mass market.

Once the company is then established in the market, control and monitoring processes tend to recede. The focus from then on is to expand market share, develop additional customer groups and business areas, and **eliminate inefficiencies**.

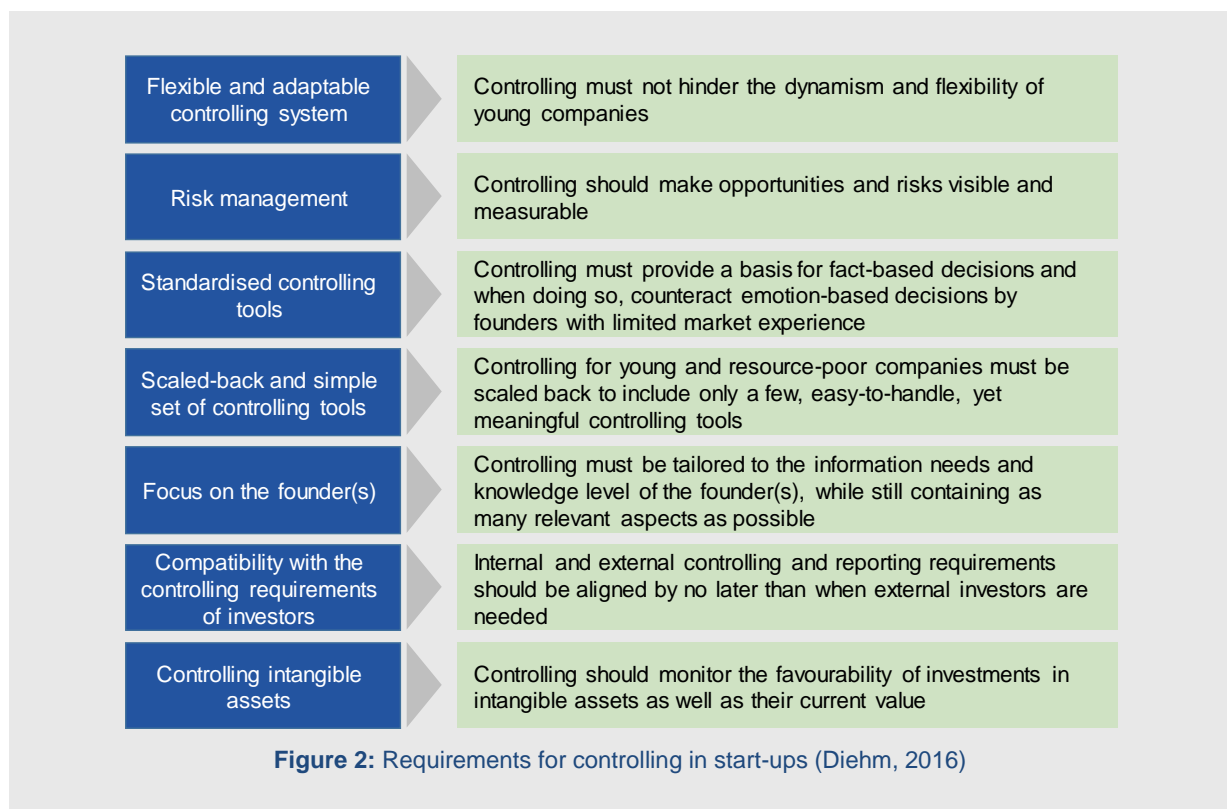


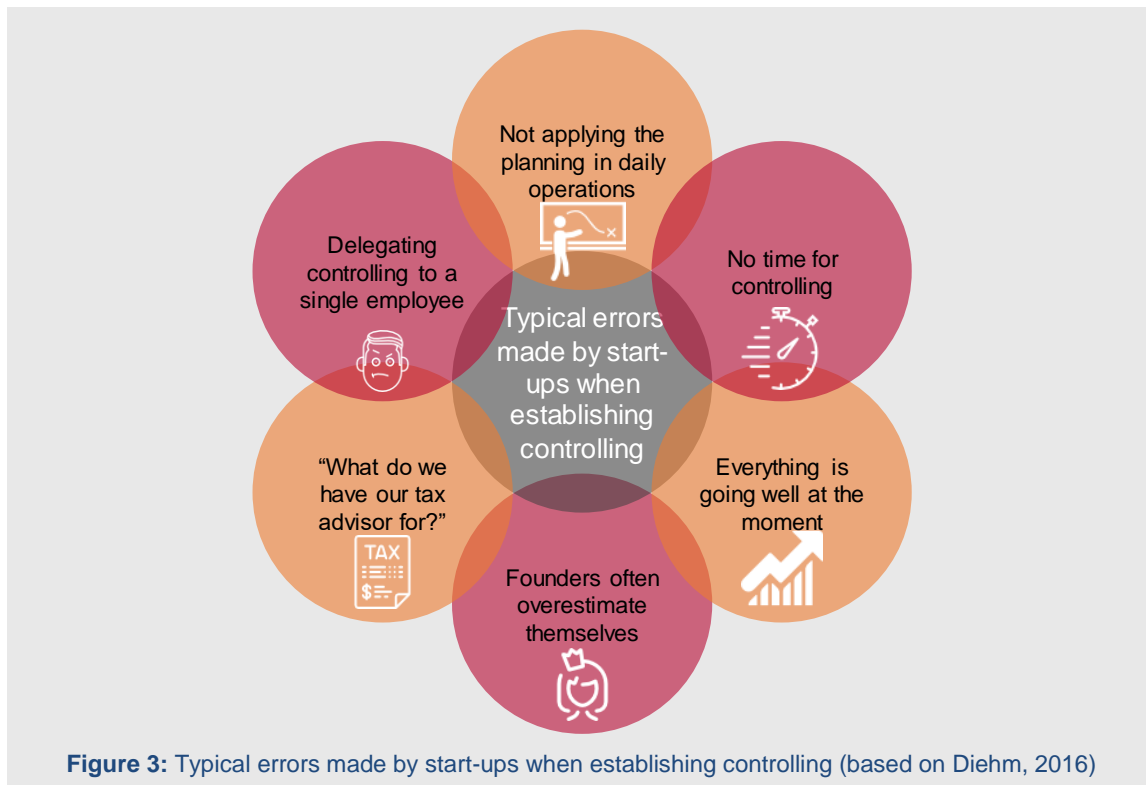
## Requirements for controlling in young and growing companies | An overview

Nowadays the complex facets of controlling must be tailored and adapted to individual start-ups. The special requirements and typical errors in the establishment of controlling are shown below.

Established controlling concepts cannot be simply transferred to start-ups due to the **distinctive features** resulting from their young company history. Compared to existing companies, the decision-making processes in young companies are particularly short. In addition, start-ups are highly **flexible** and make decisions rapidly. This flexibility, however, has a downside: start-ups require a high level of management attention due to a lack of experience, scarce resources, or their lack of robustness. This management activity can often be prone to error. As a result, traditional controlling cannot be applied due to the lack of previous experience and because of the highly dynamic state of the start-up environment, which might make today's decisions obsolete tomorrow. Furthermore, start-ups lack defined responsibilities and organisational structures because of their **limited level of formalisation**. This seemingly low level of company complexity within start-ups does not mean, however, that controlling is not needed.

Regular liquidity checks and analyses of barriers to market entry are necessary tasks, especially at the start of the foundation process. In addition, investments, which might be high initially, require **constant cost control** as well. Last but not least, external investors insist on regular reporting, which can be considerably simplified using controlling that has been previously tailored to the start-up. These aspects indicate that controlling in start-ups is no less demanding than in established companies, but that it usually must be **adapted to the individual start-up and scaled back to specific tools**. This type of customisation provides start-ups with effective and efficient controlling. Figure 2 provides a summary of the most important requirements. It should be stressed that these should be re-examined depending on the current **phase of the life cycle**.





Many founders are experts in their fields. Sometimes, however, they tend to **overestimate themselves**, especially after a first phase of growth. In the case of fast-growing companies, the degree of complexity increases as well. This mounting complexity can be counteracted through controlling tools that are thought out in advance. It frequently happens that founders – especially those without a business background – unconsciously hand over the responsibility for controlling to their **tax advisor**, or succumb to the belief that their tax advisor will take on all other financial tasks. If the founder **delegates** all controlling activities to a **single employee**, the danger may arise that the founder quickly loses the overview. The founder, though, is the person who must review and interpret the analyses because, after all, controlling is meaningful only if it results in actions. In addition, it may happen that further planning is neglected after the business plan is completed. As mentioned earlier, although long-

term planning is very difficult, the current **cost trends**, **liquidity situation** and **market environment** must always be monitored in order to take any countermeasures quickly. Furthermore, it is problematic if founders underestimate the importance of controlling and perceive the associated tasks as **annoying**. Ultimately, this perception can be very seductive when the company's current financial situation is good, making it appear that there is no need to apply appropriate controlling tools. Figure 3 provides a summary overview of these errors.

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