

Mihaylova, Lyudmila; Papazov, Emil

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Changes in the Strategic Internal Control of Companies under Crisis Pressure

Lyudmila Mihaylova, Emil Papazov

Abstract

Purpose of the article: The article aims at presenting and analysing key changes in the strategic internal control of companies under the pressure of crisis phenomena. The research question is how to adapt the strategic internal control to an evolving crisis through inclusion of control environmental sustainability measures, and strategic model adaptation.

Methodology: A qualitative approach has been applied along with the research of larger companies from the brewery sector and small-and medium sized enterprises from the knitted fabrics manufacturing sector in Bulgaria. The study has also taken into consideration some companies' strategic documents, as well as interviews with companies' managers. The gathered information has been systematized, compared and evaluated with the help of the "Relative (Competitive) Advantage Matrix" model.

Scientific aim: Understanding the impact of changes in strategic internal control on management under the pressure of crisis phenomena.

Findings: The analysing of the quasi-control environment and competitive advantages is an important strategic management issue during crises. Competitive advantages derive mainly from the characteristics of the product (or service) that make it better than the products (or services) of competitors and they are associated with changes in the strategic internal control of companies under the pressure of hard times.

Conclusions: Strategic internal control has to be adapted to the crisis situation through control environmental sustainability measures, strategic model adaptation and selected competitive advantages. Business processes are changing as a result of crisis times, then the control environment, risk assessments and competitive advantages need to be more detailed and analysed in different aspects. At the same time, the strategic internal control in hard times faces unexpected results, such as a drastic reduction in the incomes, a decrease in retail sales or a drastic increase in online sales. Using the collected information, comparisons can be made to better outline similarities and differences that will point out ways for improvement. This information should be brought to the attention of the personnel of the companies. The change in the activities should not be delayed in time, since information quickly becomes out-dated.

Keywords: strategic control, management, crisis phenomena, internal control

JEL Classification: M21, L1

Introduction

In today's conditions, a good managerial practice of different kind is accumulated by analysing and reporting on the many crises on the implementation of internal control of the organization (including this caused by the COVID-19 pandemic). Most of the opinions are associated with the idea that the increased complexity created by the pandemic environment in which management decisions are made often makes it possible to detect mistakes, abuses and frauds. In this association, it is necessary to focus on increasing the risk of disorders, influenced by the hard times (including the COVID-19 pandemic). This situation implies changes in strategic internal control of companies under the pressure of crisis phenomena. Some key control activities, control environment, strategic control models have to be analysed in the crisis context. Most frequently, linking objectives of non-financial indicators with the financial goals of a company is advisable (Kocmanova, Šimberova, 2014) and businesses are impacted by the implementation of measures towards the reduction of the environmental impact (Krmela, Tesarova, 2020; De Bruyckere, Everaert, 2021). Another opinion is that managers must take concrete action to implement a correct strategy for reorganizing accompanying facility activities in the context of crises such as the COVID-19 pandemic (Trifonova, Pramatarov, 2020). There is a need for a better management, including strong networks of leaders, control and economically sustainable projects and plans (Strielkowski *et al.*, 2020).

Business managers are currently facing a difficult environment that forces them to identify and implement innovative ways for managing an organization in order to assure the survival and development (Năstase, 2010) and corporate behaviour (Antonova *et al.*, 2018). Organizations, processes, and business models are changing rapidly and

trends, interdependencies, and this segment's specifics are unstable (Hruby, Korab, 2018). That is why changes in the strategic internal control of companies under the pressure of crises can be adapted through inclusion of control environmental sustainability measures and strategic model adaptation.

The paper focuses on issues such as control environment (being an important element of the organizational culture) together with the possibility of its formation on the branch level (the so-called *quasi* control environment) and strategic model adaptation for hard time management.

1. Review of certain theoretical aspects of the internal control

Nowadays, there is a general opinion on the specific tasks performed by the internal control or on the manner in which this should be done. At most, the internal control is entrusted with setting formal targets, monitoring processes, measuring performance and taking corrective action on the strategic, tactical and operational aspects (Papazov, Mihaylova, 2012a). In addition, the model of internal control is normally established in a manner that correlates with the development processes, whereas the idea is to continuously seek a connection with the important strategic characteristics of this management function. In this respect, the main alternatives of the strategic internal control will be analysed. They are so important because hard times are related to the element of surprise and the short time for decision-making.

Usually, the first alternative is associated with the subordination of the overall activities to some predetermined rules or the so-called "Management by Rules". The second one requires self-control and is based on shared values that are consistent with the idea of an organizational culture (Papazov, Mihaylova, 2012a).

The control frame based on “Management by Rules” requires an advanced discussion concerning all possible options that respond to any expected situation, so that managers know how to act in case of a specific situation. This type of control is centralized and includes making a large number of internal guidelines, procedures and schemes (for example, in the financial services industry, hospitals, pharmaceutical industry, *etc.*).

The internal control model based on shared values and organizational culture builds on expectations and interests. The last ones have a high influence on human behaviour. In terms of expenses, this alternative of control is less costly, but more difficult to achieve, as it is affiliated with a long-term selection, training, and approval of employees and is typically applied in project management services, creative industries, arts, *etc.*

Usually, the internal managerial control has strategic, tactical and operational dimensions. This corresponds to the idea that management’s responsibility is to realize the strategic goals and objectives through directing of tangible, intangible, financial and human resources necessary for those goals (Papazov, 2014; Hofbauer, Bergmann, 2013). Moreover, for managers, the internal control looks like an action that covers a wide variety of areas including standards, procedures, and activities designed to ensure the intended goals of an organization. The process of corporate management, including risk management and internal control, is constantly evolving to meet the growing complexity and expectations of the organization (IIA – Bulgaria, July 2013). Therefore, management is the only body that should cope with adverse circumstances in hard times or take advantage of unexpected opportunities. Having this in mind, the strategic internal control helps management to determine whether the organization fulfils its social responsibilities and legal obligations. In this sense, the implementation of an internal control system related to professional skills,

expectations, perceptions, attitudes and values, including the organizational culture, is necessary (Papazov, Mihaylova, 2012a).

Careful reading of scientific publications shows that there are five interconnected parts (elements) of the internal control of a company (Ayimpoya *et al.*, 2020; Bilgi *et al.*, 2017; Simeonov, Lambovska, 2011):

- The control environment;
- The risk assessment;
- The control activities;
- The information and communication; and
- The monitoring systems.

The practice guidelines, manuals and instructions to all forms of internal control in organizations confirm analogous understanding. Overall, the components are relevant to any companies, but in individual ways and in a varying degree, which eventually depends on the size and specifics of an organization.

The paper will focus on the control environment, being an important element of the organizational culture. It redefines the relation to control from a strategy point of view. The control environment is most often defined as the basis for all other components of internal control systems, as it imposes discipline and organization (Papazov, Mihaylova, 2012a). Usually, the control environment depends on the choice between one of two alternatives, mentioned above – control based on the rules or control based on values, organizational culture and honest communication. The control environment includes managerial opinions and actions, including the importance of the internal control. It also provides the discipline and structure necessary to get the purposes of strategic control.

According to the Association of Chartered Certified Accountants (ACCA, 2020), control environment takes account of elements, such as:

- Integrity and ethical values;
- Management philosophy and operating style;
- Organizational structure;

- Evaluation of powers and responsibilities; and
- Policies and practices in human resources / competence of staff.

The formation of a control environment is usually done at internal (company) level. However, there are also examples that demonstrate a creation of control environment taking place *outside* the organization, at the so-called quasi-institutional (branch) level. The idea is to bring later those explicitly originating ethical norms and values in the organizations, which are members of the professional community (Papazov, Mihaylova, 2012a). Any such approach is not typical, but applicable and useful in critical situations. The next section presents some examples that refer to the formation of a control environment on a quasi-institutional level as a possible reaction to crises situations.

2. Goals and methodology

The article aims at presenting and analysing key changes in the strategic internal control of companies under the pressure of crisis phenomena. The research question is how to adapt the strategic internal control to an evolving crisis through inclusion of control environmental sustainability measures, and strategic model adaptation.

The present research is based on a literature analysis on topics concerning internal control and formation of a control environment on a quasi-institutional basis in hard times. The analysing of quasi-control environment and competitive advantages is an important strategic issue during crises.

The methodology used has a comprehensive character. A qualitative approach has been applied along with the research of larger companies from the brewery sector, from the Bulgarian Hotel and Restaurant Association and its member organizations, and small-and-medium-sized enterprises from the knitted fabrics manufacturing sector in

Bulgaria. The empirical study uses case studies as a research method. The case studies represent multi-perspectival analyses and use different sources relevant to a study (Tellis, 1997). The advantages of the case study method, in addition to providing a better illustration of complex and real practical problems, include improving the manner of perceiving information and the enrichment of analytical skills (Papazov, 2009).

The study has also taken into consideration some companies' strategic documents as well as interviews with companies' managers. The gathered information has been systematized, compared and evaluated with the help of the "Relative (Competitive) Advantage Matrix" model. The applied method of empirical study is the survey of the population of SMEs, producing knitted fabrics (knitwear industry), using a fixing survey, *i.e.* the perception of different aspects of the research object. Additional aspects related to the methodology are outlined in following paragraphs.

3. Formation of a control environment on a quasi-institutional basis in hard times

The strategic control is mainly linked with the corporate strategy and through it with the relations between the company and business environment (Papazov, Mihaylova, 2012b; Al Sawalqa, Qtish, 2012; Simons, 1990; Bruggeman, Van der Stede, 1993). The control environment has an important role to play for the systematic development of internal control in business organizations in hard times. The traditional understanding is that such an environment is created under the influence of internal factors. A specific example (case studies) of the Bulgarian corporate reality shows, however, that a determinative intervention shaping the control environment results from external rather than internal inspiration and, and if we have to be pre-

cise, from established branch associations or unions. The result is common actions of all companies from the sector on important social and business issues in hard times.

The formation of a control environment for companies from the Bulgarian brewery sector in a quasi-institutional aspect is anchored in the overall sector's development in the last two decades, and especially in the role played by the Union of Brewers in Bulgaria. It was founded in 1991 as a non-profit association to protect the interests of the Bulgarian brewing industry, attracting all major manufacturers of beer and beer-related products as members (Union of Brewers in Bulgaria, 2020). The case study research shows that the brewery industry is able to manage the business responsibly with view of society. This is not a popular practice to implement the principles of self-regulation of the business communication and to actively promote the highest ethical standards related to integrity and ethical values in hard times. The self-regulation is accepted as a leading concept for the brewery industry in Bulgaria, not just as one approach to achieve excellence. It is a management philosophy and a work style aimed at the implementation of a sectoral communication strategy. As such, the self-regulation becomes part of its control environment, formed on quasi-institutional (branch) level. This understanding to extend the control environment at the branch level is helpful in hard times. During crises, it is important to underline that strategic control plays a balancing role between different company activities and focuses on main ones, concerning the production of goods and trends in their marketing. It is an easy and inexpensive approach, having in mind that the dynamically developing business environment and the intense competition make organizations struggle for each customer (Ruskova, Todorova, 2016; Rostami Mazouei *et al.*, 2017), especially in hard times.

Another case from the Bulgarian reality shows the possibility to adapt the formation

of control environment in a crisis environment. It concerns the Bulgarian Hotel and Restaurant Association and its member organizations (Bulgarian Hotel and Restaurant Association, 2020). The adaptation is oriented to a quasi-institutional formation of a control environment, based on the integrity and ethical values of the branch and policies and practices concerning human resources/competence of staff. In the hard situation, such as the COVID-19 pandemic, organizations from hotel and restaurant branch develop clear rules and procedures for action, if coronavirus is detected in a guest at a hotel (accommodation). In this case, self-regulation as an overall concept for the branch is adopted again. The responsibilities as a part of the control environment in pandemic situation are also part of quasi-institutional decisions. The branch demands that the requirement for guests in hotels and other accommodation places to wear masks on the territory of the hotel complex, outside the restaurants, be dropped. Wearing masks inside the buildings seems unnecessary, as these guests are checked at the reception upon check-in (and they are responsible for it). Wearing masks in the hotel does not increase the safety of guests, given all the measures taken in the accommodation to limit the virus and create unnecessary inconvenience to the customers (Investor, 2020). The self-regulation becomes part of the control environment, formed on quasi-institutional (branch) level and all the organizations will approve it.

The two above-mentioned cases show that in hard times the quasi-institutional formation of a control environment for the companies belonging to one branch is a reasonable decision. It is non-financial decision, but it impacts on the financial results of companies during the COVID-19 pandemic.

A modern characteristic of strategic control is its orientation towards the environment, the degree of aggressiveness of the strategy, and the possibility of undertaking a strategic reaction. In this respect, in hard times,

tools and indicators are need for realization of the internal control (strategic, tactical or operative) function taking into account the fact that it has “primarily a subordinate role in planning” (Simeonov, Lambovska, 2011).

4. Application of the “Relative (Competitive) Advantage Matrix” model for SMEs in under the pressure of crisis phenomena

An example for a tool applicable in the strategic internal control in hard times is the so-called “Relative (Competitive) Advantage Matrix”, created especially for SMEs by scientists from the Plymouth Business School, UK (Chaston, 1998). This model helps SMEs find the presence of specific competitive advantages in the context of the environment in which they operate. It is suitable for use in the strategic internal control, as small firms rarely setup complete control systems (Messeghem, 2003).

In Bulgaria, most of the enterprises (more than 99%) are SMEs and the paper presents results from an investigation conducted among SMEs from the Bulgarian knitwear industry. The purpose is to point out specific competitive advantage factors, selected for hard times. This allows a comparison between two leading companies in the selected industry. It shows the difference between the hard times position and the usual competitive presence of these companies. That is why this version of the “Relative (Competitive) Advantage Matrix” model is applicable for

illustrating the changes in the strategic internal control of companies under the pressure of hard times.

The research interest concentrates on the Southern Central Planning Region of Bulgaria. The territorial restraint enables a more thorough study of the statistical population of SMEs manufacturing knitwear fabrics, as about 30% of the enterprises are concentrated there. With regard to this and to the selected object of the survey a regional investigation has been made regarding the size and ownership of the capital, the legal form, *etc.* (Table 1).

The applied method of empirical study is a survey of the population of SMEs, producing knitted fabrics (knitwear industry) – using a fixing survey, *i.e.* the perception of different aspects of the research object. The methods of the statistical study have been used. The survey has been conducted on the basis of a previously drafted organizational plan, which specifies the units of the survey, the period of the survey, the method of recording and presentation of data, the place of the survey, *etc.* Related to the statistical study, the units of the survey are 30 SMEs. The crucial moment of the survey is 1 July 2020, and the applied forms of organization are the self-survey and the corresponding form, in which data have been collected by means of a questionnaire within a certain deadline. The information necessary for the analysis is put on questionnaire cards (including competitive advantage factors in the SME sector in hard times). The information is completed in the questionnaire by the manager or the person who

Table 1. Size and ownership of the capital of the SCR enterprises, manufacturing knitted fabrics.

Size of the enterprises	Relative share %	Ownership of the capital	
		Entirely Bulgarian	Predominantly Bulgarian
Micro firms (up to 9 people)	11	100 %	–
Small firms (from 10 to 49 people)	44	100 %	–
Medium firms (from 50 to 249 people)	41	100 %	–
Large firms (over 250 people)	4	90 %	10 %

Source: Own research, 2020.

has the greatest knowledge of the specifics of the enterprise. Bearing in mind the initial agreement with the representatives of the SMEs, the administered questionnaire is anonymous. The expertise of other organizations is used in the formulation of the questions.

The creation of competitive advantages is an important strategic management issue in SMEs. Competitive advantages come mainly from the characteristics of the product (or service) that make it better than the products (or services) of competitors. To some extent, they are also directly dependent on access to adequate and reasonably priced resources. The classical microeconomics researches competitiveness mainly in the context of the dichotomy “price – quality” of a product: a company is more competitive when it offers a product with a certain quality at a lower cost and price than its competitors (cost advantage) or – by given market price – when it offers a higher quality than its competitors (differential advantage). For many economists, however, what points out a real interest are the factors that characterize the competitive advantages of SMEs as a whole (Papazov, Mihaylova, 2012c; Musov, 2017).

In today’s strategic control models, these factors may have its place, because as mentioned, the subject of strategic control is related with the accordance of the elements of internal and external environment of SMEs, which effect on their strategy. Bamberger, who three decades ago performed one of the largest studies, synthesized twenty-six factors defining the competitiveness of SMEs. A list of these factors, together with their original ranking, is provided in the following Table 2.

The factors in the above table are applicable in the so-called “Relative (Competitive) Advantage Matrix” model. When used this model allows managers to build upon a more flexible strategic response to environmental conditions based on the competitive advantages of the small enterprise. It can be used in hard times.

Table 2. Competitive Advantage Factors in the SME sector.

No.	Factor
1	Product Quality
2	Reliability of Delivery
3	Reputation of the Firm
4	Competence of Workers (Skills)
5	Flexibility of the Firm
6	Quality of Management
7	Good Local Image and Contacts
8	Financial Capability
9	Purchasing
10	Social / Political / Economic Climate
11	Low Cost Position
12	Creativity
13	Product Image
14	Personal Selling
15	Payment Terms
16	Pricing Policy
17	Modern Techniques of Production
18	Market Share
19	Product Design
20	Engineering Capacity
21	Distribution Channels
22	Service After Delivery
23	Variety of Products
24	Advertising / Sales Promotion
25	Technical Assistance Before Delivery
26	Size of Sales Force

Source: Bamberger, 1989.

In fact, the study among 30 SMEs producing knitted fabrics, about implementation of this model in hard times was released in three phases. In the first one, the manager of each SME participating in the study, is required to select 10 of all 26 factors corresponding to the specificity of the firm, especially in hard times (having in mind COVID-19 crisis). In the second and third phase, each manager assesses the selected factors applying a ten-grade system. Ranks are added together and divided by the number of factors

to determine the mean competitive advantage score (*i.e.* the absolute competitive) of the company.

The same procedure is repeated again to obtain the mean competitive advantage score for the company's most important rival. Finally, the two calculated scores are compared to determine the coefficient of the relative advantage of the studied SME to the referent company in hard times. If the calculated coefficient is greater than one, the surveyed company should consider itself stronger than the competition.

Table 3. 10-Ranked competitive advantage factors in the SME sector producing knitted fabrics in Bulgaria, selected in hard times.

No.	Factor
1	Product Quality
2	Reliability of Delivery
3	Flexibility of the Firm
4	Good Local Image and Contacts
5	Personal Selling
6	Payment Terms
7	Distribution Channels
8	Service After Delivery
9	Variety of Products
10	Technical Assistance Before Delivery

Source: Own research, 2020.

The results from three steps are illustrated below. In crisis times, this model can be used for comparison, having in mind different 10 ranked competitive advantage factors in the SME sector producing knitted fabrics in Bulgaria (Table 3).

These competitive advantage factors, selected in hard times are different from the usual ones for the industry. Therefore, the absolute competitive and the coefficient of the relative advantage of the studied leading firms in the sector are different in hard times.

After the selecting 10 ranked competitive advantage factors in the SME sector producing knitted fabrics in Bulgaria, the two leading SMEs have been compared. Having in mind the anonymity of the study, the enterprises have been marked as company "A" and company "B". The results are shown in the next table (Table 4).

The mean of competitive advantage score (the absolute competitive advantage) of the companies is as follows:

- Competitive advantage score (the absolute competitive) for Company "A" = $81:10 = 8.10$,
- Competitive advantage score (the absolute competitive) for Company "B" = $77:10 = 7.70$,

Table 4. Competitive advantage factors in 2 selected leading SMEs in Bulgaria in hard times.

No.	Factor	Company "A"	Company "B"
1	Product Quality	7	8
2	Reliability of Delivery	10	9
3	Flexibility of the Firm	10	8
4	Good Local Image and Contacts	9	10
5	Personal Selling	7	6
6	Payment Terms	8	7
7	Distribution Channels	9	8
8	Service After Delivery	8	7
9	Variety of Products	7	6
10	Technical Assistance Before Delivery	6	8
TOTAL:		81	77

Source: Own research, 2020.

- The coefficient of the relative advantage of the studied SME “A” to the referent company “B” in hard times = $8.10:7.70 = 1.052$.

Therefore, the conclusion is that in hard times, the company “A” is stronger than the main competitor – company “B”.

The “Relative (Competitive) Advantage Matrix” technique also contains a module for evaluating the factor levels in different periods: the respondents are required to assess the factors in retrospect (three years before) or provide for their condition in the future (three years after). The results obtained complement the notion of the dynamic processes in the field of competitiveness. This module is suitable to be used for the purpose of strategic control, as the selected factors describing SMEs’ competitive position can be perceived as controllable parameters oriented towards changing the SMEs’ absolute competitiveness in hard times.

If uncertain, poorly predictable and unpredictable changes of the ten key factors are established, the controlling unit (or responsible manager) will propose a significant change of strategy or looking for other strategic alternatives in hard times.

The method is easy to use and does not require serious resources. The weaknesses of “Relative (Competitive) Advantage Matrix” model may prominently include the fact that from all specific elements of the (business) environment only competition is considered.

Conclusion

The strategic internal control has to be adapted to the crisis situation by including control environmental sustainability measures, strategic model adaptations and selected competitive advantages. As business processes are changing because of crisis times, the control environment, risk assessment and competitive advantages need to be more detailed and analysed in a different aspect. At the same time, the strategic internal control in hard times faces unexpected results, such as a drastic reduction in the incomes; a decrease in retail sales, or a drastic increase in online sales. Using the collected information, comparisons can be made, which will show similarities and differences and will point out ways for improvement. This information should be brought to the attention of the personnel of the companies. Changed activities should not be delayed in time, since information quickly becomes out-dated. Having this in mind, some changes in the strategic internal control of companies under the pressure of crisis phenomena are presented. The analysis of quasi-control environment and competitive advantages is an important strategic management issue. Competitive advantages derive mainly from the characteristics of the product and service that make it better than the products and services of competitors and are associated with changes in the strategic internal control of companies under the pressure of hard times.

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Assoc. Prof. Dr. Emil Papazov

University of National and World Economy,
Sofia

Business Faculty

Real Estate Property Department

1700 Sofia, Student Town “Hristo Botev”

Bulgaria

E-mail: epapazov@gmail.com

Assoc. Prof. Dr. Lyudmila Mihaylova

University of Ruse “Angel Kanchev”

Faculty of Business and Management

Department of Management and Business

Development

7017 Ruse, 8 Studentska str.

Bulgaria

E-mail: lmihaylova777@gmail.com

