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Master’s Degree in International Economics and Commerce
Business Organization and Strategy

MANAGEMENT CONTROL IN FASHION COMPANIES

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ABSTRACT

Fenomeno culturale e sociale, la moda italiana è l'emblema dello stile e dell’eleganza del Belpaese. Tale settore è caratterizzato da un’elevata dinamicità e, allo stesso tempo, da un’intrinseca difficoltà nel prevederne i trend futuri vista la variabilità dei gusti dei consumatori. Al fine di ovviare a tali criticità e, allo scopo di monitorare le prestazioni dell'azienda, limitare l'incertezza delle scelte imprenditoriali e prevedere le prossime tendenze, sostanziali diventano gli strumenti utili alla gestione del processo decisionale. L’obiettivo è dunque quello di ottenere informazioni puntuali e sistematiche per implementare opportune scelte gestionali e, per questo motivo, lo studio del controllo di gestione applicato al settore dell’high fashion risulta fondamentale. In primo luogo, è necessario evidenziare le caratteristiche del comparto moda, partendo dall’analisi del ciclo di vita dei prodotti attraverso un approfondimento sulla *Trickle-Down Theory*, la più antica teoria sulla moda. Quest’ultima, prevede la diffusione delle tendenze procedere dall’alto verso il basso, ovvero dalla cima della piramide sociale fino alle classi sociali inferiori, attraverso un processo di “differenziazione/imitazione”. Proseguendo, vi è una dettagliata descrizione delle peculiarità che contraddistinguono i prodotti moda dagli altri presenti sul mercato, mettendo in luce l’importanza della stagionalità, la quale rappresenta uno degli elementi rimarchevoli da tenere in considerazione durante l’attività di controllo.

Al fine di comprendere al meglio il concetto di controllo di gestione, nel secondo capitolo sono analiticamente esaminati gli elementi che lo costituiscono: la formulazione degli obiettivi che derivano dalla visione strategica, le attività manageriali che consentono la realizzazione degli obiettivi precedentemente formulati e, infine, il controllo che rappresenta la fase conclusiva del processo inerente al sistema e che consente di analizzare le differenze che sorgono tra le

previsioni e ciò che realmente è accaduto. Tutto richiede alla base del processo una struttura forte ed accurata di misure di gestione e, quindi, strumenti e metodologie coerenti con l'attività svolta, i quali diventano parte integrante del sistema.

Successivamente, nel terzo capitolo lo studio si protrae con l'identificazione delle principali tipologie di costi specifici per il settore considerato e delle varie metodologie utilizzate al fine di allocarli nel miglior modo possibile, concentrandosi soprattutto sull' *Activity Based Costing*. Tale metodo consente di evidenziare le cause che determinano i livelli di costo, identificare il trade-off che opera all'interno dell'organizzazione, sviluppare consapevolezza nei confronti del fornitore e del cliente e, infine, determinare e valutare il movimento di dati e informazioni, in modo tale da poter agire consapevolmente sulle fonti di vantaggio competitivo. Di primaria importanza è, inoltre, la determinazione della deviazione tra ciò che è stato programmato e ciò che è stato effettivamente realizzato, consentendo così di comprendere le cause di tali variazioni e le aree di business coinvolte. Suddetto processo è portato avanti grazie all'utilizzo dei *Budget*, strumenti in continuo adattamento rispetto alle esigenze dell'impresa moda, in termini di stagioni, prodotti e altre primarie necessità. Infine, vi è l'implementazione della *Balanced Scorecard*, supportata da *indicatori economici-finanziari e fisico-tecnici*, i quali permettono di analizzare la corretta esecuzione del controllo di gestione, prestando particolare attenzione ai fattori critici di successo, al fine di modellare le future scelte gestionali volte ad ottenere un elevato vantaggio competitivo.

TABLE OF CONTENTS

INTRODUCTION

Concerning the world of fashion, Italy has a lot to tell: Made in Italy has now become a real lifestyle, conquering the global market since it is a perfect combination of quality and functionality, market-oriented creativity and a full-fledged craftsmanship. Despite this, the high fashion sector has been the subject, since the end of the nineties, of numerous extraordinary operations that have completely redesigned the competitive scenario, such as globalization, counterfeiting, decline in sales, appreciation of euro and a climate of general mistrust, which invaded the international markets putting the Italian economy in serious crisis. In particular, the Italian fashion system is characterized by a high seasonal content production which, in the past, found in the small family business an adequate tool provided with flexibility, specialization and responsiveness. However, today this all sounds to be no longer enough. In fact, in addition to the change of the competitive scenario, there is also the difficulty for this sector to predict future trends, given the variability of consumer tastes and, consequently, an erroneous prediction of the same could result in damaging the companies' balance sheet.

To face these difficulties, there is the necessity to invest in technical training, to innovate and rediscover the quality as a value. The ever-more sophisticated consumer needs guarantees in order to justify his purchase, which is why the high fashion company must commit itself to provide the latter with a product that has a history made of high-quality raw materials, qualified human resources and work dedication. Having punctual and systematic information is the base for the development of alternative options and to monitor the company performance, giving a valid support for intuitions and risk appetite, qualities that belong to the individual entrepreneur. To limit uncertainty, tools are needed to manage the decision-making process in terms of: measurement (or the ability to analyse data and develop products and sales campaigns based on reliable data), rationality (or the ability to set up the business organization consistently with the objectives to be achieved), intuition/experience (the ability of taking risks, make decisions, motivate employees). In the high fashion companies, these terms are translated into the information system, of budget and reporting, into the organizational structure, which evolve in the management control system. The latter is fundamental in order to implement corporate choices aimed at achieving the set objectives by taking into consideration the internal and external environment of the company.

The first chapter of this thesis provides a general description of the fashion sector and about the etymology of the name, moving on with a brief clarification regarding the evolution of the same in Europe. Subsequently, in order to understand the structure of the high fashion market, the subdivision of the various bands that make up the market has been outlined, starting from the mass-market to the haute couture and prêt-à-porter.

Continuing, the theme of the sector segmentation has been deepened, which can no longer be based exclusively on the Porter's Five Competitive Forces model but, takes into consideration the configuration of a company's value chain according to the Three-Dimensional Business Definition model or Abell's model, including the technology, customers and needs of the latter. After that, the analysis focused on the life cycle of fashion products and on the logic of the collections, specifying the importance of seasonality, a fundamental peculiarity of this sector. Turning to the details, the main characteristics of fashion products and what distinguishes them from others have been described, in order to identify the target customers suitable for these goods. Finally, in order to give a further explanation about the life cycle of fashion products, the analysis of the Trickle-Down Theory has been carried out, which explains how fashion products " born and die" on the market, deepening the various phases which it consists, in order to act in the best way to stay on the market.

Going on with the second chapter, the attention has been focused on the most important topic concerning the "management control". At the beginning, there is a brief definition of the management control, divided into a strategic planning process, planning of the corporate activity and a further cross-sectional process of the business operating cycle through which the management ensures the acquisition of the resources and their use in an efficient and effective way to achieve corporate objectives, which is the control; these are carefully examined in the composition. Furthermore, the four essential elements that make up the whole management control system have been analysed: the information system, the organizational structure, the processes, the revelations and information. Regarding the processes, the concept of the Business Process Reengineering has been studied in depth, especially its philosophy and the phases that make it up. Proceeding with the core of the composition, the objectives of the management control and the control levels analysed by Anthony have been presented, considering the operational, directional and strategic control, up to the phases in which the system is articulated and, also, the actors involved. Thereafter, the study on the information structure of the management control has been deepened, that is a set of technical-accounting instruments able to represent the economic-financial part of the objectives and the operational programs, allowing the detection of the actual values and allowing to carry out an analysis of the deviations. In addition to these tools, there is also a mention regarding the off-balance sheet typology, of particular interest especially in the field of fashion, because they focus on qualitative performance indicators in order to achieve competitive advantage.

In the last part of this research, the previously covered topics have been taken up again but examined in depth from the high fashion sector perspective, namely the Fashion Control System. First of all, there is the description of the implementation process of the management control system based on the ever-changing needs of the sectorial companies which transform through time, the analysis of the external environment and its economic dynamics. Moreover, the composition moves on with the characteristics of the business in which the company operates and the identification of the critical success factors. The determination of the tools for an adequate accounting management, the identification of objects and cost configurations are also important, in fact, they are the starting point for the implementation of the entire analysis and for having a set of information to support the management control. Furthermore, there is the description of the main typologies of specific costs for the high fashion sector and the various methodologies used in order to allocate costs in the best possible way, focusing above all on the Activity Based Costing, which passes from a logic for centres of responsibility to one focused on activities. Another important instrument of the control that has been studied is the budget, whose information converges within the reporting system to carry out analysis of the differences between the data in the preliminary and final budget, and to arrive at the elaboration of final projections. Finally, there is an in-depth analysis of the Balanced Scorecard, a performance evaluation model that can be implemented according to the needs and characteristics of the high fashion sector, laying the foundations for the future management. Furthermore, a detailed study of the 4 perspectives that make up the BSC has been done, together with the related Key Performance Indicators, which investigation is crucial to reach the customer satisfaction and to guarantee an adequate level of innovation, considered essential elements for the high fashion companies in order to achieve a good performance.

CHAPTER I: THE FASHION INDUSTRY

The first chapter has the aim of introducing and illustrating every element and characteristic of the fashion industry: starting from a more general view with a clarification about the meaning of the word "fashion" and its origins, moving on to the fashion sector analysis and focusing on the productive process and collection's logic, to conclude with a detailed study of the fashion product from its distinctive features to its life cycle. Fashion companies necessarily need to be aware of this information in order to survive on the market taking the right strategy decisions and, especially, to best handle the management and control process which is the core phase for every firm working in this sector.

1.1.The etymology of fashion

"Fashion is a universal principle, one of the elements of civilization and social custom. It involves not only the body but all the means of expression available to people"[1]. This quote explains that clothing is the expression of a development in custom, social context, culture and lifestyle, in a context that is much wider and complex than clothing itself.

Starting from the Italian language and therefore Italy, where fashion etymology was born in 1650, this word derives from the Latin *mos*, with the

[1] Devoto G., *"Il dizionario della lingua italiana",* Le Monnier, Milano, 1995

meanings of: a) usage, custom, habit, tradition, b) law, rule, kind, c) regulation, good manners, morality.

Georg Simmel identifies the fashion system as a social mechanism that displays itself mainly, but not exclusively, in clothing. He, in the essay on fashion of 1895, defines it as a social cohesion's system that allows to conciliate the closure of the individual within a group, deducing that fashion is driven by imitation and the distinction reasons that a social circle transmits in a vertical approach to the community [2].

If in the past, the concept of fashion was almost exclusively associated with clothing, in the last years it has increasingly spread to further segments as accessories, furniture, household goods, travel destination and domestic pets: what is still evident today, as in semi-primitive societies, is man's willingness to use fashion as bodily adornment, as if there were something unsatisfying about natural attributes [3].

Cloth is no longer a commodity but an instrument to show off your own wealth and to demonstrate your social identity, for these reasons fashion has a close relationship with *luxury* which recall the idea of distinctiveness, selective and unavoidably expensive.

A *luxury good* has essential characteristics that differentiate it from other productive categories: first of all, the extraordinary quality of the product, thanks to the employment of the most excellent raw materials available in the marketplace, perfect manufacturing and absolute technical skills. Moreover, the validity of the offered service also affects the quality of the product, in this area of interest, the choice of the distribution channel is fundamental since it should be as selective as possible. Only in this way, the high fashion industry guarantee to its customers a special and personalised service.

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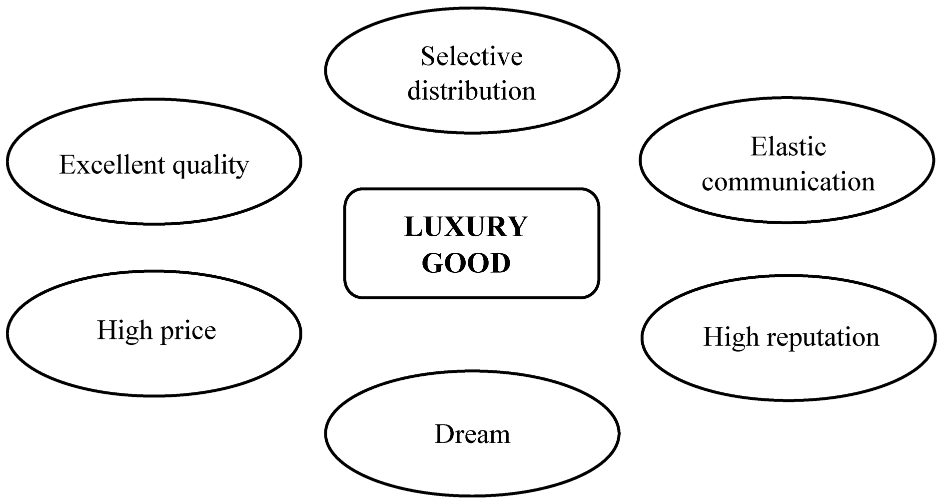
[2] Simmel G., *"La moda"*, Mondadori, Milano, 1996

[3] Anderson Black J., Garland M., *"A History of Fashion",* Orbis Publishing Limited, Londra, 1990

Figure 1.1 – Luxury good characteristics



Source: Our elaboration

The customer should have the perception of a “dream product”, in fact, also the price barely coincides with the real cost and has a psychological justification, therefore, the value attributed to the product is that perceived by the potential buyer: a luxury good represent, in any case, a unique experience for the consumer.

1.2. Fashion industries

After having studied each facets of the fashion word meaning, it is time to step forward. For the purpose of better figuring out the main traits of the fashion industries, it is appropriate to examine the evolutionary journey of fashion market in the EU from the early Renaissance to the present day, moreover, in order to clarify the sector's peculiarities, it is necessary to divide it into bands based on price and other critical success factors. After that, it is indispensable to find out the structural segmentation of the clothing industry to identify the demand characteristics and organize the value chain configuration. In fact, the fashion company's decisions take into consideration also its productive process, which, in addition, influences company's choices, together with the collections' timing.

1.2.1. The evolution of fashion market in EU

In Europe there are two major world players in the fashion industry: France and Italy.

The real birth of the fashion phenomenon can be dated back to the early Renaissance when attention to the dress becomes a systematic sign of a clear social distinction, in fact it starts to symbolize the differentiation among social classes.

Later, in the era of Louis XIV and especially in the nineteenth century, the centre of fashion becomes Paris and, in those years, welcomes who will be considered the greatest British designer: Charles Frederick Worth, independent *couturier* who not only made clothes on commission for the aristocratic class, but will also begin to realise products for the *petit-bourgeoisie*.[4] However, the changes occurred in the second post war-period came to light new social classes, as well as the contextual emancipation of women in the society and in the workplace, which produced a democratization of fashion. In this period born, especially in Italy, the *prêt-à-porter*[5]: high quality products made with an industrialized system, able to reduce processing costs, thus making a product accessible to these market segments. Moreover, Italy begins to play a relevant role at global level, throughout Palazzo Pitti's catwalks and thanks to the strong link between fashion and industry which arises in Milan. Our country decided to focus not on the *haute-couture,* just like French did, but on sought-after products with great stylistic and creative content, more accessible from an economic and wearability point of view.

Nowadays, textile and clothing sectors have a huge economic relevance in Italy: the fashion sector's revenue represent the 1,3% of the Italian GDP [6], however, in order to stay on the market, companies are called to implement a revolution within its own production chain to face and overcome the challenges imposed by the 4.0 technology.

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[4] Saviolo S., Corbellini E., *"La scommessa del Made in Italy ed il futuro della moda italiana"*, Etas, 2004

[5] Ready-to-wear or *prêt-à-porter* is the term for factory-made clothing sold in finished condition and in standardized sizes

[6] Casini F., *"Moda italiana, un settore in crescita",* 8th March 2019, Article published on "Kompetere Journal", www.kompeterejournal.it/moda-italia-economia-abbigliamento/

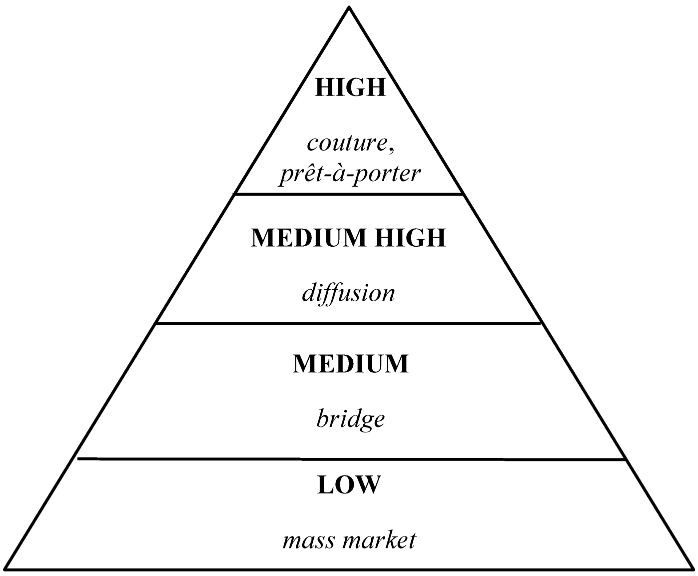
1.2.2. Sector diversification

Aiming at understanding the fashion market structure, it's essential to illustrate the bonds among the different sector areas and the conceptual dissimilarities.

Based on the price, the fashion system can be structured according to a pyramid scheme in which four levels are highlighted, where between one segment and another, in addition to prices, change also other critical success factors such as quality and materials, fashion content, product differentiation and demand uncertainty.

The division that characterize the sector can be easily and clearly represented through the explanation of the following table.

Figure 1.2 – Fashion market subdivided by bands



Source: Pambianco C., *"Le strategie delle aziende della moda nei nuovi scenari di mercato"*, VII Conference of Pambianco Strategie d'Impresa, Milano, 2002

The lower-end, which comprehend the *mass market* products, is composed by moderate price goods with a low stylistic content: they are basic and little differentiated products. At this level, we find two different categories: *better*, that includes the most economic lines of industrial brands (such as Fila, Diesel), and *moderate*, that instead, welcomes the commercial lines (such as Zara, H&M, Benetton), as well as the *unbranded* products.

The second step is given by mid-market products, *bridge*, with a certain stylistic content but with affordable prices, they are manufactured for young people that ask for a specific quality product but without the characteristic of the uniqueness.

This segment born as a "link" between the lower-end and the mid-market products, from this derives the name "*bridge*", and it has the capability to create market's innovation in short time.

The third division regards the medium-high range, *diffusion*, that will appeal to wealthy class that are willing to pay for ground-breaking products or higher quality one. The target includes young people with fair financial means, in search of fashionable products at accessible price, the most common examples are Emporio Armani, D&G and Versace.

The higher-end, lastly, is made up of high fashion products characterized by a substantial stylistic content and that are not purchased for their effective quality, but for the experience and sense of belonging they cause in those who wear them.

The last one must be divided, in turn, in two segments: *couture* and *prêt-à-porter* or *ready to wear*. *Couture* has typified the Italian and French high fashion since the nineteenth century, in such period the *haute couture* or *couture creation*[7]

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[7] *"Haute couture or couture creation are legal denominations safeguarded of which can rely upon exclusively the houses that yearly appear on the list drawn up by a Commission which belongs to the French industry minister. In 1968 opened in Paris the Chambre Sindacale de la Couture Parisienne, that establishes requisites for the qualification of high fashion house and consequently*

was the most requested handicraft activity where the couturier creates a tailor-made dress for the client.

However, *prêt-à-porter* or *ready to wear*, differently, born in the seventies in Italy precisely in Milan, the capital of fashion houses as Armani, Fendi, Versace and other industrial brands as Prada and Hugo Boss.

This segment is characterized by high priced and fashionable products, repeatedly up-to-dated to follow the fashion trend, but not unique and inaccessible. In this field, what matters more are the *brand* and the symbol of the *griffe*, which have a huge advertise cost.

1.2.3. The market structure and segmentation

Starting from the Porter's Five Competitive Forces Model[8] that are: threat of new entrants, threat of substitutes, bargaining power of customers, bargaining power of suppliers and competitive rivalry; we can determine the competitive

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managing the section. The member qualification is, even now, restricted to couturiers that own specific titles and which accept subjection to a certain number of rules oriented at defining the collection's presentation, timing of models' realization etc"

Saviolo S., Testa S., "*Le imprese del sistema moda: il management al servizio della creatività"*, Edizione 2, Rizzoli-Etas, Milano, 2005

[8] *Porter's Five Forces* is a model that identifies and analyses five competitive forces that shape every industry and helps determine an industry's weaknesses and strengths. Frequently used to identify an industry's structure to determine corporate strategy, Porter's model can be applied to any segment of the economy to search for profitability and attractiveness. The model is named after Michael Eugene Porter, an American academic born in 1947 and known for his theories on economics, business strategy, and social causes

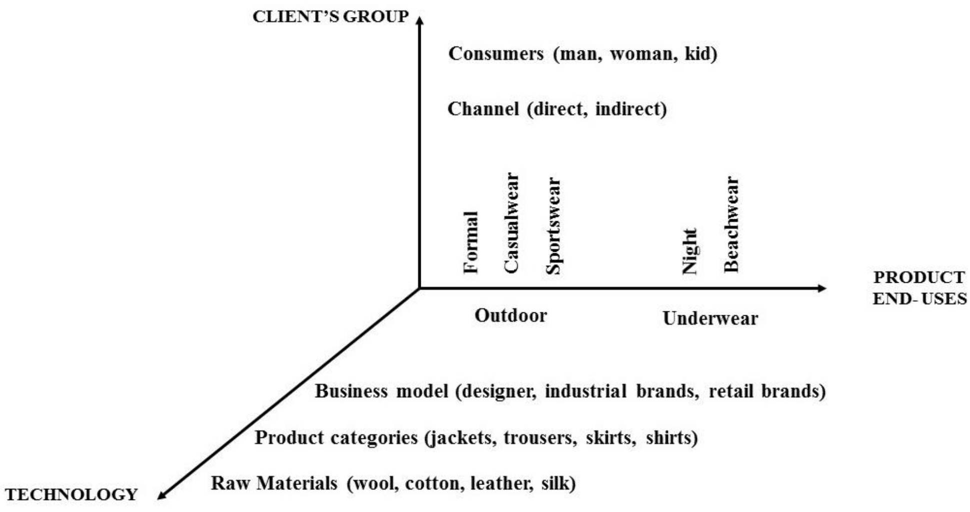
intensity and the attractiveness of an industry in terms of its profitability. A sector can be segmented into more competitive areas when the differences in products, customers or functions of use alter one or more of the five forces. Moreover, the segmentation of an industrial sector does not only identify the different needs of the demand but entails differences in the entire configuration of a company's value chain, generated by a specific combination of product, market and technology.

Considering the fashion sector together with the Three-Dimensional Business Definition model or Abell's Model, which is segmented into three macro segments:

- Client's Group (who are the customers);
- Product End Uses (what are the customers' needs);
- Technology (how are needs being satisfied).

In this way, it is easier to analyse how the abovementioned sector defines and runs its own business.

Figure 1.3 – Structural segmentation of the clothing industry



Source: Saviolo S., Testa S., *"Strategic Management in the Fashion Companies",* Etas, Milano, 2002

The first macro-segment is *Technology,* in other words, the dimension that describes the way in which the functions sought by the customers are satisfied and what the possible alternatives are. In the sector under examination, the technology segmentation criteria are based on the business model, product categories and raw materials used. Regarding the product, a first distinction concerns the two technologies that are features of the clothing industry, textile production and knitwear. These sectors have different production cycles because of the different nature of the raw material used, moreover each of these macro-categories can be further segmented on the basis of product type. There are three types of business models in the industry, and these define three types of actors:

- maison or designers (for example Armani, Valentino, Versace, Calvin Klein, Ralph Lauren), they are based on design and know-how, with a strong product orientation and now, they are leading production or licensing firms with a range of highly and diversified products outside clothing (accessories, perfumes, household articles, etc);
- industrial brands (for example Zara, Max Mara, Hugo Boss, Fila, Diesel), their know-how is both industrial and commercial with a strong market orientation. They have a well-developed range of products and are positioned in different market segments;
- retailers (Benetton, Stefanel, Decathlon), they manage retailing, have commercial and sales know-how, and are often able to organise their own supply chain through external manufacturing.[9]

The segment concerning the *Product End Uses*, on the other hand, describes the type of use for which the product was conceived from a technical and functional point of view, specifically in fashion we mean, for example, the external or intimate

[9] S. Saviolo, S. Testa, *Op. cit.*

use of an object. Materials, shapes, structures and finishing process can be different according to product end-uses, for this reason there is a strong relationship between a certain end-use and a certain technology/manufacturing process.

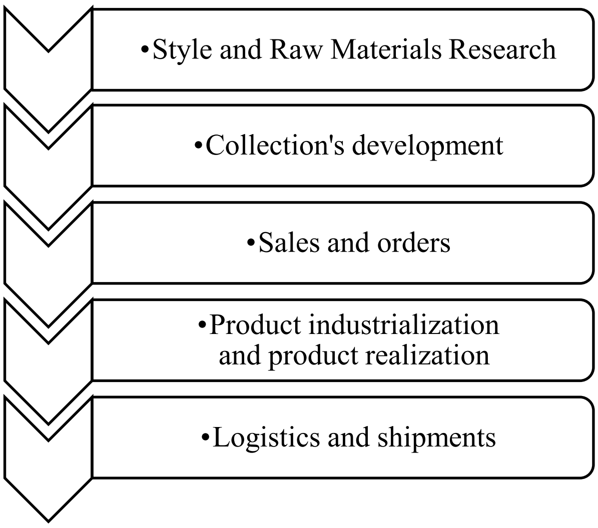
Finally, the third macro-sector is the *Client's Group,* that determines the final consumers, but also the distribution channel that will be used, which can be direct if it puts industry and consumer in contact without the commercial intermediation service; indirect, on the contrary, includes specialized actors in commercial intermediation with product distribution functions.

1.2.3.1. The productive process

After having analysed the market structure and segmentation, we need to focus on the explanation of the fashion companies' productive process in order to better understand in which way the decisions that the company has to take are influenced by the characteristics and timing of each process.

We schematize the productive process flow with the following intuitive diagram.

Figure 1.4 – Fashion companies' productive process



Source: Our elaboration

Style and Raw Materials Research: the research of new raw materials and the style have always been the fashion's soul, in fact they are the first step of the process.

Many aspects of the company's activities depend on this phase, starting from the brand commercial success until you get to the evaluation of the profitability based on the labour cost, raw materials chosen and on the processing part.[10]

This step can be split in three essential moments:

- market trend study. The fashion houses try to get an idea about future trends, attending exhibition of raw materials suppliers. They activate themselves in

[10] Marasca S., Marchi L., Riccaboni A., *"Controllo di gestione. Metodologie e strumenti"*, Knowità, Arezzo, 2009

advance with respect to the future collections, in this way they can identify the cloths maker market orientation, as well as the typology of colours and materials. Moreover, it's relevant to define the stylistic approach of the designer based on past data, in this manner he will be able to understand which models had more success in the past;

- collection theme identification. Each collection presented by the fashion houses has a central idea at the base, which can concern the choice of colour, material, print that the designer will make use of on all the clothes articles;
- models' design and prototyping. In this phase there is the prototype development by assembling the raw materials chosen. This is a very delicate phase for the final quality of the product as it gives rise to the characteristics of future products. Before starting to design the various prototypes, it should be studied the various characteristics of the materials, their functional and aesthetic yield, the needs of the consumer and his perception of quality. This represents the most creative phase of the whole process that however, will have to reflect the consumers' needs, quality targets, avoiding difficulties that could occur during the productive process, obstructing and slowing down it.

Collection's development: After completing the aforementioned phases, the style office presents its proposals to the company's general and commercial departments. The management at this stage will evaluate the various proposals and decide what introduce into the collection that will be presented, based on price considerations, commercial opportunities, realization times and other elements.[11] Once the collection's proposal is agreed upon, it starts the central phase that involves the models' realization which will be presented to future clients. At this

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[11] Garrison R.H., Noreen E.W., Brewer P.C., Agliati M., Cinquini L., *"Programmazione e controllo: managerial accounting per le decisioni aziendali"*, McGraw-Hill Education, Milano, 2012

stage, we have to bear in mind that the timing has a key role: it is reduced, since, on the one hand, confirmation of the samples to be presented in the collection is delayed as much as possible in order to perceive all the possible evolutions of the market and, on the other hand, the date of presentation cannot be delayed as the market does not tolerate delays. Furthermore, the man-times necessary for each processing phase must be carefully calculated, considering the production capacity of the pattern-making department.

Sales and orders: The moment of the collection's presentation represents the crucial phase of the process, in fact there is the exploitation of all the energies spent in the previous months by the whole company. The current market structure is bound to the so-called "fashion weeks", that is, dates on which all companies present their samples and start selling. Presenting the collection late means losing a huge amount of turnover, because customers have already committed to other companies. Moreover, we must consider the different channels through which the customer views the collection. The substantial distinction is found on the model in which the company is organized, so that the less articulated companies generally make use of a sales network based on the figures of representatives and agents, multi-brand or exclusive, who turn directly to the customer. Because of that, the most qualified companies offer their collections through showrooms or direct sellers specialized by type of product or by type of customer. In addition to the indirect sales channel, a lot of sector companies have their own network of single-brand stores divided into "flag ship stores" located in prestigious locations whose purpose is represented by the communication of the image rather than turnover goals, and "company store" able to offer their products with greater attention to clients' necessities, thanks to the possibility of managing these activities internally.

Product industrialization and product realization: As soon as the first orders are received, a forecast plan of the quantities to be produced is drawn up, which will be updated and finalized once the sales campaign has ended. The production phase begins before the sales phase is completed, because the long delivery times of the raw materials would not allow to respect the finished products' terms of delivery agreed upon with external customers or with the shop managers of single-brand stores. At this point, it's necessary to develop the MRP (Material Requirement Planning) to know how much, when and by whom to receive the material aiming at completing the production. Based on the delivery of the various materials on the bill of materials, it will be possible to start the real production phase, which can usually be organized according to the "island production model" or the "batch production model". "The island production" system is usually adopted when low production volumes must be realized with a high variety of different processes. "Batch production" instead is used where the complexity is high but the volumes, unlike island production, are high.

Logistics and shipments: The logistics phase groups together the phases of handling, storage, and transport of goods. To schedule warehouse operations, so that people and facilities are adequate and available at right time, it is necessary to be aware of the production program's returns and the customer delivery schedule. However, it must be remembered that production arrivals and deliveries are not constant, therefore, the warehouses must be dimensioned close to the peak of activity with regards to the structure, while they will seek help from seasonal hiring for labour force activities. Logistics is sometimes outsourced, that is given in concession to organizations specialized in this activity. In this way, companies avoid both the cost of investment in the warehouse and its structures, which are often quite expensive, and the cost for the staff, as much remarkable.

1.2.3.2. The collection's logic

The collection is composed by all the garments made for a specific season, taking into consideration the product's multiplicity, variations and different types of use.[12]

For collection we mean the different possible combinations between the seasonal dimension and the product line dimension, moreover, it is relevant to highlight that it influences all the operating activities of the companies in the sector.

The leading peculiarity of the fashion world is the "seasonality": autumn/winter (A/I) and spring/summer (S/S), where for each one it will be presented a new collection composed by updated products (*basic*) and ongoing products (*fashion*).

Seasonality influences the fashion companies' activities and, consequently, the management of purchases and sales, which will be focused in specific periods of the year. This seasonal cycle of the fashion chain involves a high complexity in the creative and operational dimension of the companies, that have extremely tight times for the realization of the collections and for the management of the sales, production and delivery process.

[12] Terzani S., *"Controllo di gestione nelle imprese di alta moda",* Franco Angeli, Milano, 2007

Figure 1.5 – Collection identification

		PRODUCT LINE	
		MAN	WOMAN
SEASON	S/S	COLLECTION A	COLLECTION B
	A/W	COLLECTION C	COLLECTION D

Source: Our elaboration

Regarding the collections, three key factors can be identified to understand how seasonality affects the entire process and what is the impact on the entire company: breadth and variety, degree of innovation and articulation modality.

By *variety and breadth*, we mean the number of item codes in terms of both product and individual components, present within the collection, where a high number of variants is countered by a loss of operational efficiency.

The *degree of innovation,* or variability, requires the change of the different components of the offer with the necessity of times and competences independent from the process of development of the collections.

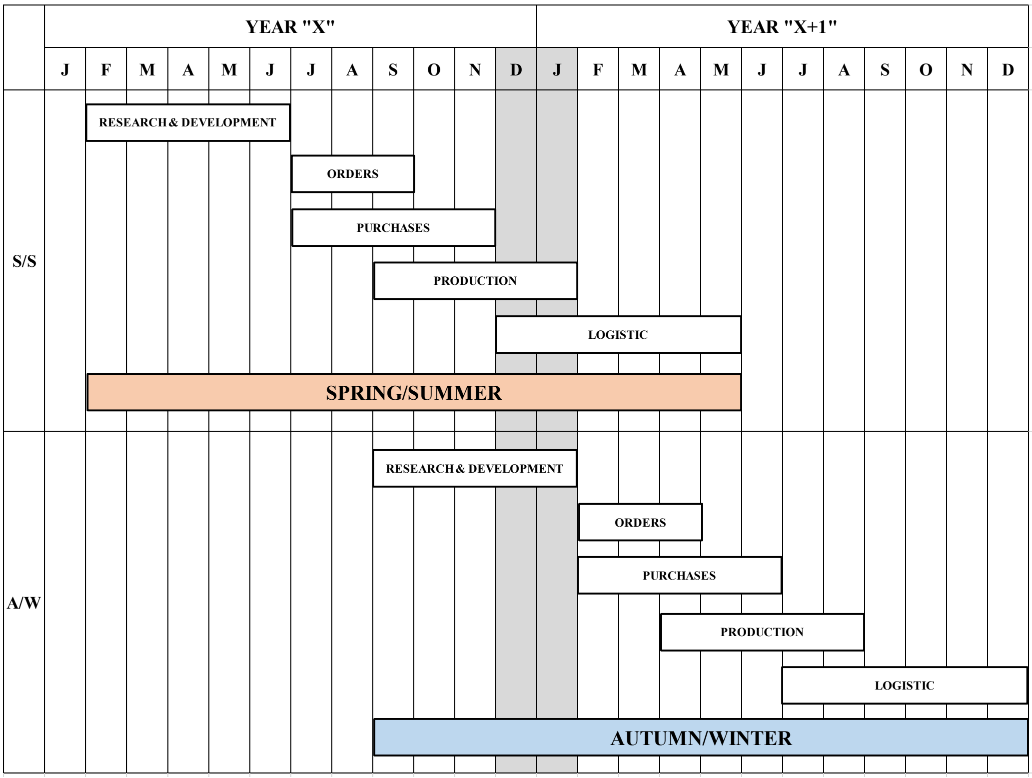
Finally, the *articulation modality* act on the balance between the effectiveness of the proposals and the available company resources.

The fashion company operates in a complex way, in fact it must work simultaneously on three collections, due to the seasonal cycle, providing the management and the analysis of the economic results of the past season, the monitoring of the current management trend and the fine-tuning of the collection for the following season, through an adequate programming and control system.

Going in depth, we can explain more precisely the functioning of the three collections coexistence:

- "S/S" collection of year "x+1" affects the period from February of year "x" to May of year "x+1";
- "A/W" collection of year "x+1" starts from September of year "x" to December of year "x+1";
- finally, the following "S/S" collection goes from February of year "x+1" to May of year "x+2".

Figure 1.6 – Fashion companies collections' timing



Source: Bubbio A., Cacciamani S., Rubello U., Solbiati M., *Il controllo di gestione nelle imprese del fashion*, Iposa, Milano, 2009

As can be easily deduced, the developing process of the collections is very articulated and takes place at a hectic pace, because the time of presentation cannot be postponed, therefore companies will have to operate the development of the collections through a structured process, a precise definition of the times and the resource requirements.

The relevant phases which the company must be aware of are:

1. the definition of collection guidelines;
2. the definition of the structure and the collection plan;
3. the executive development of the collection.

The first phase leads to the definition of the general characteristics of the collections under planning, which cannot disregard the analysis of the previous collections. In fact, it is supported by the knowledge and experience of the marketing area, which knows the sales trend, needs, expectations and degree of satisfaction of the final customer.

The second step goes into details, in fact it regards the collection planning and programming, pointing out the collection's offer quality and quantity, taking into consideration the different product end-use and the stylistic innovation, which allows to develop the merchandising plan.

Finally, we have the executive development that provides, from the merchandising plan, a series of activities aimed at the realization of the prototypes and subsequently the copies of samples for the sales network and for the commercial one.

1.3. Fashion products

At this point, the focus moves to the fashion product, which is the essential element of the whole study. It can be differentiated based on various features and, as a result, on the related target market. Moreover, as every product on the market, also a fashion product has an own life cycle, better explained by Simmel's theory, which influences company's decisions.

1.3.1. Fashion products features

"The value of a product is not in itself, but it is related to its ability to meet a specific set of needs. Needs can be material and only related to the product's functional attributes, or they may be tied to the consumer's psychological and socio-cultural motivations and thus to the product's intangible values"[13].

The concept of product can be interpreted in different ways as explained by Hetzel in the following table.

[13] S. Saviolo, S. Testa, *Op. cit.*

Table 1.1 – The concept of product

THE PRODUCTS AS IT IS	THE PRODUCTS AS WHAT IT EVOKES
The product as use	The product as magic
The attributes	The products recall its origins
The product as appearance	The product as essence
The product as certainty	The product as questioning
The product as related to nature	The product as a symbol
The product as only reality (it can only be useful)	The product's surrealistic aspect (it can be absolutely useless)

Source: Our elaboration of: Hetzel P. J., *"Imprese di moda e marketing: la semiotica come aiuto nelle decisioni"*, in Grandi R. (ed.), "Semiotica al marketing", Franco Angeli, Milano, 1994

A fashion product has a relevance that goes beyond its functional features, in fact it communicates an attitude or a lifestyle.

However, not all products of the fashion system can be regarded as communicative media or cultural product, in fact, they can satisfy basic functional needs or intangible needs that are located in the higher part of the Maslow's pyramid of needs. For this reason, it's indispensable to classify the fashion products into three categories, which differs by frequency and level of consumers involvement in the purchasing process, by degree of differentiation, and by product cost.

Convenience goods: they are defined as substitutable goods with an accessible price and easily purchasable. The consumer make use of it in his everyday life, indeed they are called commodity goods and have to be managed as a service to the client (availability of sizes and colour, deliveries on time, replenishment). Moreover, they satisfy primary needs and are not subject to fashionability, as for example, unbranded or private label products.

Shopping goods: these goods accommodate psychological or effective needs, generally have a high price and require a strong market orientation. They include branded products with an emotional attributes and scarce substitutability, in fact, the customer doesn't have all the elements needed for deciding and must carry out evaluations of alternatives.

Specialty goods: this category has specific physical (completely new style, new materials, better performance) or intangible features that evokes emotions, which make them unique. The distribution of those products is selective, and the cost is generally, but not necessarily, high. Moreover, it is not easy categorize products in this group because they are function of subjective considerations, as a matter of fact, this category could include both couturier and mass brand products.

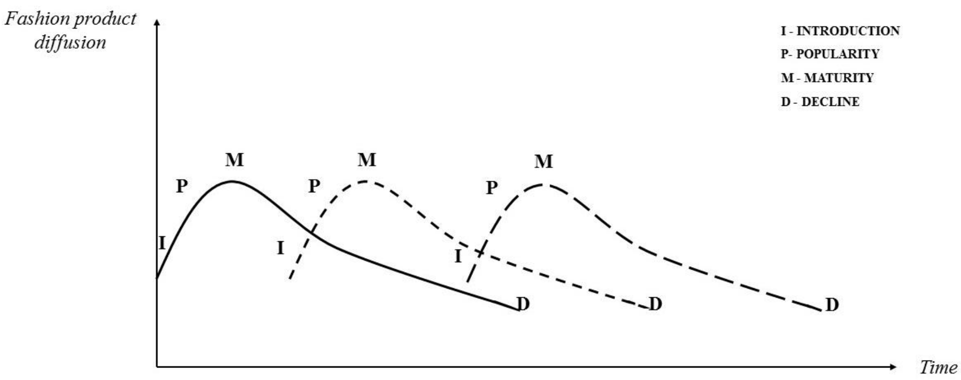
Moving from *specialty* to *convenience* goods, there is a progressive decrease in the importance of intangible aspect of the product, and an increase in consumer power and rationality in the purchasing process. The ideal condition for a fashion company is to offer *specialty* products because, with respect to the *shopping* ones, they allow to gain extra profits and competitiveness. However, it is of main relevance to determine the segmentation and positioning strategy, in order to define the best market target and offer them products perceived as unique.

1.3.2. Fashion products life cycle and Trickle-Down theory

The fashion cycle is the period of time between the introduction of a certain fashion (a new product, a new look) and its replacement by a new one. The replacement may concern basic features (concept, style, basic materials, accessories), or variants (colours). According to the historical evolution of fashion, it can be stated that the characteristic of variability over time generates a process of constant and continuous change caused by the natural cycle of the seasons and by the cycle of fashion in strict sense. Generally, fashion houses are likely to present new models for each collection, maintaining their characteristic style that identify them from the competitors and introducing some reinterpretations of classic products.

Every fashion product has its own life cycle, characterized by the progressive succession of the introduction phase, acquisition of fame and popularity, maturity, decline, exit from the market.

Figure 1.7 – The concept of product



Source: Our elaboration

Introduction: the initial phase where fashion companies launch their new products on the market which represent the running trend of the season. After fashion designers have carefully assessed customer expectations, they try to attract consumers' attention to their products by investing heavily in advertising or by giving some of their products to subjects capable of attracting considerable attention thanks to their fame. Therefore, the purchase of a fashion product generates a feeling of belonging to an elite, differentiated from the rest of the consumers, making the customer a follower of the one who enjoys this reputation[14].

Popularity: phase in which the implementation of the introduction phase takes place. The most fashion-conscious followers buy the first pieces to satisfy their belonging need.

Maturity: the article produced by the brand acquires its maximum popularity at this stage, now it is widely known and appreciated, and sales have reached their peak.

Decline: during this phase, there is a decrease in the quantity of fashion followers and no intention to buy the product unless it is offered with an attractive price.

Exit from the market: finally, the product becomes obsolete, so the consumer is no longer interested in wearing the previously purchased garment. There is even a real rejection.

However, despite the fashion follow a standardized cycle, it has several scenarios for different products. There will be products that will reach the maximum notoriety in a short time, but they will decline at the same pace, or products that instead take a long time to achieve the notoriety peak but, simultaneously, remain

[14] Selleri L., *"Contabilità dei costi e contabilità analitica: determinazione quantitative e controllo di gestione"*, Etas, Milano, 1999

for a long time in this phase[15]. Therefore, the product life cycle can be considered as one of the persuasive reference points for the definition and implementation of policies and market strategies[16].

Fashion companies are in an everlasting condition of rivalry that can be illustrated with the so-called *Trickle-Down Theory*[17] elaborated by Simmel and based on the concept that fashions are created so that the upper classes can stand out from the others. Such theory holds to be true that the above-mentioned fashions, which born and develop at the upper classes, pass to the lower social classes in a gradual way, drop by drop, becoming patrimony of all.

Consequently, it can be stated that a fashion product is an element of differentiation only at the first stages of his life cycle, indeed, when everyone can have it, it ceases necessarily to be fashionable because it loses its uniqueness and creativity. According to the *Trickle-Down Theory*, before that happens, the upper classes will have already found a different "taste" with which identifying and that, with the time, it will spread out to the rest of society triggering a process of massification. For this reason, the most successful fashion companies are those who are able to give their products an identifiable style, capable of withstanding more time to market changes.

Simmel's theory highlights the idea of saturation, from which it follows that fashion to be such, must not be followed by the majority of the population, but by a small elite, a theory that is overstepped by other scholars who highlight other

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[15] Scannerini A. L., *"Le strategie di diversificazione nelle imprese di alta moda"*, Dami, Pistoia, 2000

[16] Foglio A., *"Il marketing della cultura. Strategia di marketing per prodotti/servizi culturali, formativi, informativi, editoriali",* Franco Angeli, Milano, 2005

[17] The *Trickle-Down Theory* is the oldest fashion theory elaborated by Simmel. It focuses on the adoption of fashion from the top of the social pyramid, that is later adopted by the lower social classes

aspects of the fashion phenomenon. Initially Konig specifies that mass industrial production and the presence of higher incomes even in the lower classes, makes the Trickle-Down Theory lose its validity because it determines the spreading of fashion phenomena both horizontally and from bottom to top. Thus, it is affirmed the *Trickle Across Theory* which summarizes the limits of the previous one in two concepts: the status symbol's central role and the insufficient attention to institutional, organizational and market structures that guide the fashion process.

Blumer instead denies the fashion process's hierarchical relationships among classes, but talks about collective selection, in other words fashion has a social function related to the rationalization of taste and modernity concept.

The definitive overcoming of the hierarchical model is developed by the *Trickle-Up Theory*, which specifies that it is the market that elaborates behaviours that, after the spreading process, are adopted by fashion brands and then moved to the top of the market: the single and the communities dictate the new fashion.

CHAPTER II: MANAGEMENT CONTROL INSIGHTS

2.1. Management Control definition

The concept of Management Control was initially defined by Robert N. Anthony (1965), one of the most important and well known havardian author of the second half of the 20th century. His book "*Planning and Control Systems: A Framework for Analysis*" states that Management Control is "*the process by which managers ensure that resources are obtained and used effectively and efficiently in the accomplishment of the organization's objectives*"[18].

Moreover, Anthony affirms that it is an activity interpreted as a natural necessity, which requires a specific organization and appropriate technical-accounting tools. His theory lies on two main pillars:

- separation between objectives' formulation and realization, with an allocation among strategic planning, directional control and operational control activities;
- the principle of the "objective impersonality"[19], which assumes a constant and homogeneous response of workforce to the summit's directives. It represents a powerful distribution channel of control systems [20].

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[18] Anthony R. N., "*Planning and Control Systems: A Framework for Analysis*", MA: Division of Research, Graduate School of Business Administration, Harvard University, Boston, 1965

[19] Gallinaro S., "*Teorie del controllo*", Milano, Franco Angeli, 1990

[20] Pozzoli S., "*Il "doppio ruolo" del controllo strategico*", Rivista Italiana di Ragioneria e di Economia Aziendale, n. 1-2, 2004

As time goes on, it takes on the meaning of a set of mechanisms with the aim of increasing the probability that people acquire an appropriate attitude in order to reach business objectives [21], especially in an ever-changing environment where becomes essential introducing monitoring systems for planning and control process aiming at verifying the responsiveness to changes.

Anthony lays the basis for the birth and evolution of Strategic Control and its detachment from traditional forms of control, it is defined as "*the process of deciding on objectives of the organization, on changes in these objectives, on the resources used to obtain these objectives, and on the policies that are to govern the acquisition, use, and disposition of these resources*"[22].

Management Control is indispensable to evaluate if the management performance is in harmony with the strategic objectives established during the planning process, verifying their validity and, eventually, adapt them to changing needs.

In conclusion, it can be stated that an interpretation of the articulated concept of management control is represented as the application of the organizational tools necessary so that the strategies decreed with strategic planning are effectively and efficiently implemented.

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[21] Flamholtz E., "*Il Sistema di controllo come strumento di direzione*", Problemi di gestione, n. 3-4, 1980

[22] Anthony R. N., *Op. cit.*

2.2. Planning, Programming and Control Process

2.2.1. The components of planning, programming and control system

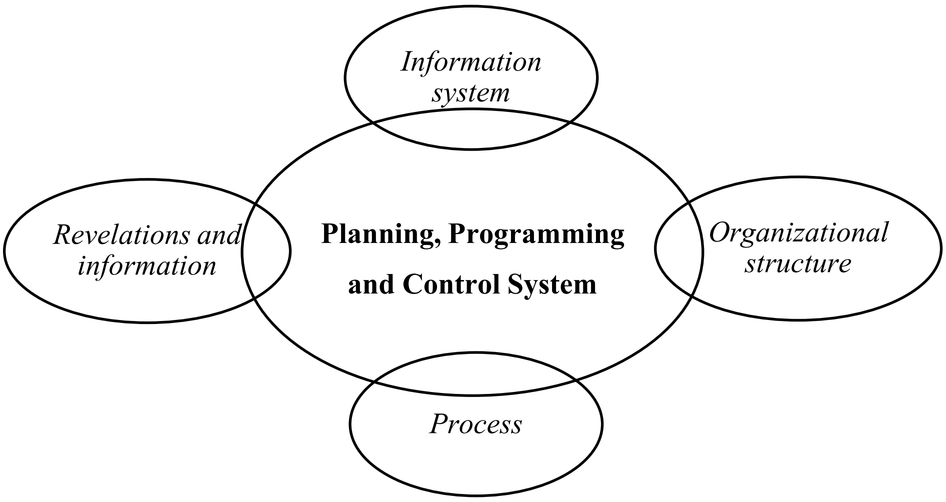
Management and control system, in turn, includes the planning, programming and control systems, and is the natural evolution of traditional accounting. Gathering the three components planning, programming and control within a unique system, it highlights how these are inevitably interlinked, in fact, the system is based on two closely related nuclei connected with a logical relationship.

The first component concerns the formulation of the objectives which derive from the strategic vision, with the aim of influencing the choices of future management, this phase includes forecast components that reflects the planning and programming processes. The second, instead, is represented by managerial activities that allow the realization of the objectives formulated previously. Control represents the conclusive step of the process inherent in the system and allows to analyse the differences that arise between the forecasts and what has occurred.

Everything requires at the base of the process a strong and accurate system of management measurements and, therefore, tools and methodologies consistent with the activity carried out: these tools become an integral part of the system.

The various components of the Planning, Programming and Control System will be progressively analysed, as well as the individual parts of which it is composed and the operating methods with which they are implemented.

Figure 1.8 – Planning, Programming and Control System components



Source: Our elaboration

2.2.1.1. The information system

The useful data for the company's internal and external activities, are contained in its information system. The corporate information system is defined as a complex network of elements, aimed at providing cognitive inputs for company decisions, in which objective and subjective profiles coexist[23]. Both the authority of the strategic summit, and those of the intermediate line and the operational core, through its use, can easily access the information they need to make the most appropriate decisions.

[23] Ferraris Franceschi R., "*Pianificazione e controllo vol. 1"*, G. Giappichelli, Torino, 2007

Nowadays, modern computer techniques have enabled highly integrated information systems[24] to be created, especially for medium and large companies. For example, we have ERP (Enterprise Resource Planning) systems that allow, among other things, to communicate directly with subjects outside the company. Essentially, the corporate information system is composed of two components.

The first includes the physical or material component, that is, the hardware and software used for collecting, processing and transmitting information. The second component concerns the coordinated set of information and the procedures used for communication within the appropriate times and ways, to satisfy the cognitive needs of those who must use them for decision-making purposes or for the fulfilment of civil and fiscal obligations. The objectives of the information system concern the documentation of administrative facts and consequently the dissemination of information outside the company, but especially internally for management and decision-making goals. It provides the tools involved in the planning, programming and management control system: it must be able to elaborate plans, prepare budgets, process final information through analytical accounting, summarize everything in reports and elaborate information for external users, finally it produces all the reports and other documents relating to the corporate activity imposed by law.

The corporate information system can ideally be divided into two subsystems:

- off balance sheet information system, where both quantitative and qualitative information concerning the company, the market and the external environment are collected and organized. Examples are internal statistics, economic information, market and socio-economic analyses;

[24] Saita M., "*Configurable Enterprise Accounting (C.E.A.) – Il Sistema Amministrativo Configurabile*", Giuffrè, Milano, 1996

- accounting information system, made up of quantitative information concerning internal and external management events. This part of the information system includes the general accounting, the analytical accounting, the budget.

The whole system is composed by a series of inputs that flow into the databases of the first accounting notes which, thanks to the use of integrated administrative systems, feed both the general accounting system and the analytical accounting management system. The analytical management accounting system compared with the budget allows to make the reporting system work, which is fundamental for the management control process.

2.2.1.2. Organizational structure

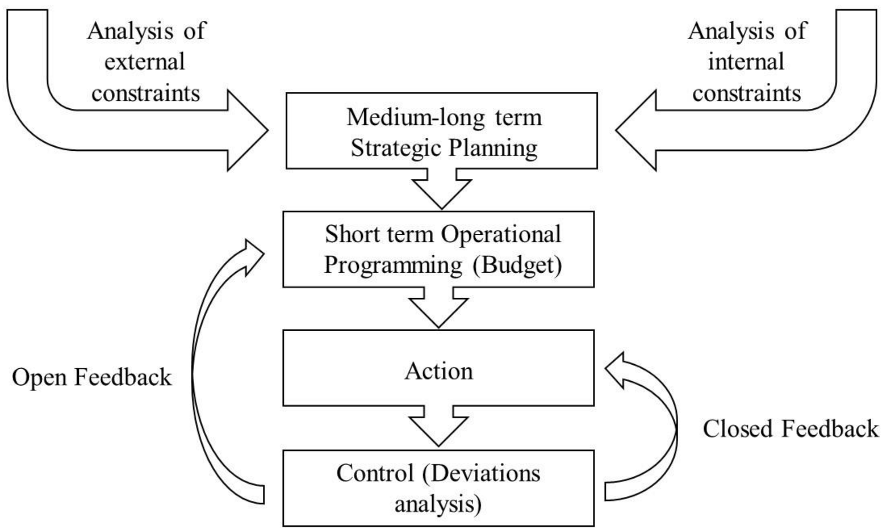
The organizational structure assumes particular relevance within the planning, programming and control system. In its complexity, in which decision-making power and responsibilities are widely scattered throughout the structure, the top management is not able to completely centralize them. This allows the harmonious development of the company, in which senior management carries out a process of decision-making decentralization, gradually delegating part of its powers to underlying organizational units, creating a power pyramidal structure. The correct distribution of responsibilities in the planning and programming process is an essential element for the control system and, to do this, the company is subdivided into centres where the responsibilities converge on certain variables, whose analysis in the control phase, allows the evaluation of the achievement of the objectives established by the managers. Usually, responsibility centres can be classified:

- expense centre, the responsibility is bestowed to the manager and is represented, almost exclusively, by the containment of the expenses sustained within the centre, therefore by a better utilization of the resources that have been assigned to him;
- cost centre, the responsibility of the head of the centre consists in the costs control and in the observation of determined standards of efficiency. This is the case, for example, of production centres and auxiliary production centres;
- revenue centre, based on products and services revenues. They are, for example, sales organizational units (branches, products, commercial channels), which summarize revenues by product, channel, geographical area, etc. To achieve optimal results, the manager has several variables at disposal including sales volumes, prices, the number of sellers, the incidence of commercial expenses;
- profit centre, the responsibility entrusted to the manager is determined on the basis of both revenues and costs of production factors, therefore in terms of contribution margins. For example, auxiliary production centres, which accept both the costs of the production factors purchased to carry out their activity, and the revenues deriving from the transfer prices to the production centres for the service rendered to them;
- investment centre, where the responsibility is focused on investments (both of fixed capital and working capital) and is measured by the return on invested capital (ROI - Return on Investment);
- financial centres, in which the financial flows converge. The efficiency of these centres is measured by the cash flow they generate;
- accounting centre, a fictitious centre into which the accounts that have no economic or financial significance merge together. A typical one is the assets centre in which the capital invested for the buildings and the costs related to the use and management of the same are grouped.

2.2.1.3. Process

The system under consideration is by definition a logical process of events, conditions, analyses, feedback interdependent and which are part of a broader unitary process: planning, programming and control. This process can be summarized as follows:

Figure 1.9 – Planning, programming and control system's Process



Source: Our elaboration

The starting point of the process consists in the *analysis of the internal and external constraints* of the company. Every business decision regarding the objectives to be achieved cannot be excluded from a careful and preventive feasibility check, thanks to which the external and internal conditions that limit the concrete possibility of implementing the programs are known in advance.

Table 1.2 – Internal and external constraints

INTERNAL CONSTRAINTS	EXTERNAL CONSTRAINTS
Economic, social, political and legal conditions	Availability of expert employees
Market and global demand configuration	Existence of adequate technological resources
Number of competitors, market shares and production and commercial policies	Availability of production factors
Situation of the labour market, technology and other production factors to be used	Possibility to acquire the necessary financial means
Capital market situation	Situation of the company organization and of relations between the subjects of the company

Source: Our elaboration

With the information relating to internal and external constraints that are processed by the information system, it is possible to make business decisions to achieve company goals. At this point, the phase of *corporate planning* begins, which elaborates the medium-long term choices that involve the dimensions, the production structure, the distribution network and the corporate image, which are aspects that cannot be easily modified in the short term. The plans are then transformed into *operational programs*, setting short-term objectives that allow to achieve the levels of profitability and advancement forecasted by medium-long term plans. Here, it can be established the actions to resolve the problems of current management and the subjects responsible for the achievement of the objectives.

As the business activity takes place, *control* is carried out, that is the monitoring of the management results compliance with the planned objectives. Therefore, the control must be implemented during the business activity and not at the end of the reference period. This allows, if necessary, to take corrective actions to redirect the management on the basis of what is foreseen in the programming phase. The feedbacks are corrective measures consequent to the occurrence of a deviation. In particular:

- if the cause of the deviation is internal, or inefficiencies occur in some company departments that can be eliminated through appropriate corrective actions, a closed feed-back is implemented. Action is taken on the operational phase, to avoid repeating the reason that generated the deviation in the future;
- if the cause is external and uncontrollable, it starts an open feed-back process, where the programs are modified in order to prevent the conservation of unattainable goals.

The current economic systems are characterized by a growing competitive dynamic, a global competitiveness and a fast-technological evolution, that is a phenomenon which make markets disturbing and, consequently, companies are forced to react with flexibility and proactive attitudes to external environmental changes. It is advantageous for companies acquiring abilities to reply, in an efficient and prompt way, to alteration of the reference context.

The *Business Process Reengineering* (Bpr), represents a managerial technique developed to effectively reorganize the company management when it is no longer satisfying to reach the required performance. The definition of *reengineering* is "*a reconsideration and redesign of business processes intended to achieve extraordinary improvements regarding the performance as costs, quality,* *service and promptness"*[25]. In essence, the Bpr is one of the main techniques to develop and maintain the company with the aim of meeting market needs and exceed the competitors. As has been explained in the previous sub-chapter, a company is a system made up of strategies implemented throughout the functioning of business processes, which make use of other infrastructural corporate structure elements as human resources, IT resources, processing and transportation technologies.

In order to deeply understand the Bpr philosophy, it is necessary to analyse its distinctive characteristics regarding:

- customer orientation and value creation: the client is an entity, individual or a group, company or office, which uses the activity output deriving from a company process activity. It is accentuated the client process role, in fact, the business activity fulfilment must be oriented towards the maximum satisfaction of the client, within a perspective of *"new ideal customer focus"*[26] and, therefore, in terms of value creation;
- focus on company processes: processes are the starting point of the reengineering, they are *"configured coordinations and dimensioned of individual homogeneous operations having a common motivation"*[27]. Obviously, a Bpr project entails, after a redrawn of company processes, consequences over the organizational structure, the employees dimensioning and company costs.

At the time when customer necessities are clear, and the company's offer is established, it is appropriate to go forward with the reengineering process. This activity allows rebuilding the logical and natural sequence of the activities that are part of it, by the elimination of practices that do not contribute efficiently to the achievement of the final result:

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[25] Hammer M., Champy J., *"Ripensare l'azienda"*, Sperling & Kupfer, Milano, 1994

[26] Champy J., *"Reengineering Management"*, Harper Collins, New York, 1995

[27] Ferrero G., *"Impresa e Management"*, Giuffrè, Milano, 1987

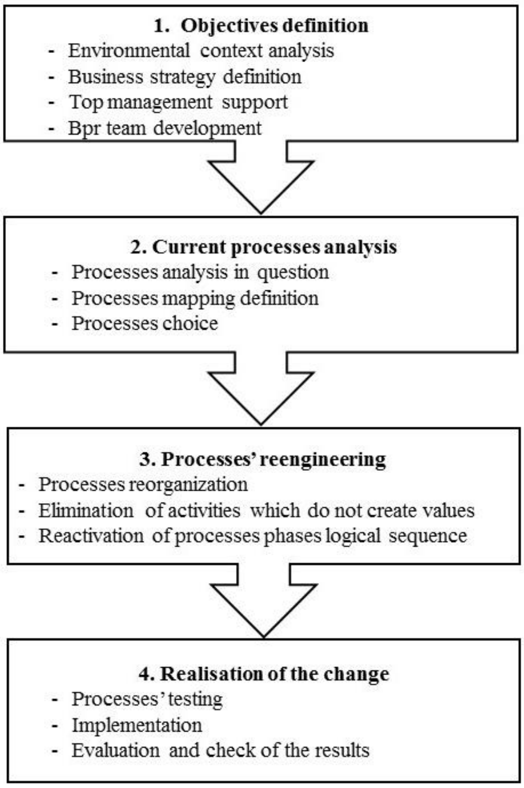
- the radical nature of change: the Bpr requires the capability and willingness to redraw the processes from scratch and independently from the existing situation, especially with respect to organizational, technical and technological aspects;
- the support of the top management: a key element for a reengineering success is represented by the support of the top management, in fact, the change planning is top-down and, moreover, it is directed, supported and driven by the top management that act as a promoter of the change;
- strategy redefining: the Bpr is implemented when processes are inappropriate with respect to the company objectives, so that, it is essential to define a strategy and then verifying if current processes are coherent with the new mission;
- performance improvement: the typical Bpr objective must be *significant*, because marginal improvements are not advantageous for a Bpr approach and *measurable*, in fact it is meaningless not having a clear indication about the starting situation, the objectives and results effectively reached. Performance improvement concerns the productivity, output quality, transportation timing and costs reduction.

The main phases of a Bpr project are essentially four and are depicted in the following Table 1.3.

Phase 1 – Objectives definition

The first step consists in the environmental context analysis in which the company is integrated, essential as starting point in order to reformulate the new strategies. Analysing the environmental context means to verify the company's positioning in the market with respect to the competitors, in terms of ability to satisfy customer needs. The sharing of the objectives with the top management is fundamental since it is the supporter of the reengineering work, helped by the Bpr team.

Table 1.3 – Bpr implementation phases



Source: Bocchino U., *La guida del Sole 24 ore al Controllo di Gestione: principi generali, tecniche, strumenti e applicazioni*, Il Sole 24 Ore, Milano, 2011

Phase 2 – Current processes analysis

Processes analysis produces a set of information which are a basic database regarding the organization functioning and of the variables at the base of company performances. The processes analysis is articulated in two moments:

- processes mapping: first of all, it is necessary to carefully identifying the company processes. It is essential to ascertain the suppliers' inputs, the output and the beneficiary clients of the output. This step must be translated in the so-called processes mapping, that is a flow diagram with the company activities, the work flow which highlights the logical sequence, the ramification and the bonds among the different activities;

- critical processes selection: it consists in the identification of processes to be subjected to reengineering and, consequently, the critical processes selection. An unsatisfactory process functioning or a process with a scarce strategic relevance, involves the need of redrawing the inefficient ones[28].

On the basis of the relevance with respect to the strategy and the level of efficiency, they are object of reengineering those projects with a stronger impact regarding the pursuit of the strategy.

Phase 3 – Processes' reengineering

This is the core phase of the whole project, undertaking this step it is relevant to make intervention on some variables called *levers of change*. These are:

- organizational variables: organizational structure, operational mechanism and leadership style go through some changes with the aim of adapting to new redrawn models, with a decrease of hierarchical levels and the redefinition of roles and relationships among subjects;
- IT and information system: there are undeniable advantages regarding the implementation of new information systems which consist in the opportunity of simultaneous access and sharing of information among different individuals and places, high potentiality of elaboration at paltry costs and contained times, possibility of exploiting specialized competences thanks to a system of software;
- human resources management: this is the most fragile factor in a reengineering process, since it is required a change in the way employees work and a replacement of them competences. The interventions must create an appropriate

[28] Bocchino U., "*La guida del Sole 24 ore al Controllo di Gestione: principi generali, tecniche, strumenti e applicazioni*", Il Sole 24 Ore, Milano, 2011

corporate culture and manage the opposition to changes throughout clear and strong communicative forms to all operative levels. In this phase there is the elimination of those activities that do not create value.

Phase 4 – Realisation of the change

The last step is the launch of the new processes in their final version. In order to verify some anomalies, it is necessary the testing activity and if the functioning is satisfactory, the implementation takes place. Once the latter has concluded, some evaluation mechanisms take place to ascertain the suitability of processes in the *continuum* of the company management.

2.2.1.4. Revelations and information

For the planning, programming and control system, costs represent information of fundamental importance, in fact, they are parameters for the business decisions of the management. This means choosing among the different alternative actions what conveniently guarantees the achievement of the objectives defined in the planning phase. In order to determine which of the proposed alternatives is the best, they must be evaluated in terms of resources to be used or, more precisely, in terms of costs.

The cost represents, in a technical meaning, the consumption of productive factors in view of a useful purpose. From an economic and monetary point of view, costs are the values attributed to the consumption of basic production factors (raw materials, labour costs, costs for services, etc.). By production cost, instead, we intend the sum of the consumption values of the individual production factors for a given operation[29].

In the planning, programming and control system, the determination of costs has cognitive purposes, in fact, they are used to evaluate the final inventory stock, to proceed with the evaluation of budget items (such as inventories and economy constructions), to determine sales price[30], to measure economic results and identifying efficiency calculations.

Moreover, costs have control and decision-making purposes in the context of management control, comparing the final results with those foreseen in the budget, which are normally determined on the basis of standard costs. Furthermore, costs are used by management for decisional purposes regarding make or buy choices.

2.2.2. Planning

The planning phase is defined by Lorange as "*that activity which allows to manage situations of change according to objectives that have been previously established and that are realized with a series of actions to be developed in a logical temporal succession, where each one submits others to constraints*"[31].

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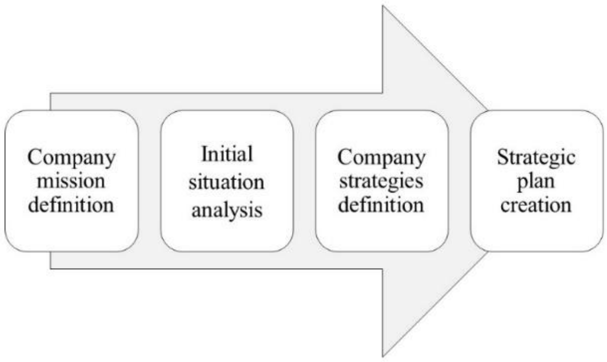
[29] Facchinetti I., "*Contabilità analitica, calcolo dei costi e decisioni aziendali*", Il Sole 24 Ore, Milano, 2001

[30] The costs of individual products are not used to establish sales price, but to guide sales policies with consequential effects also on price policies

[31] Lorange P., "*Pianificazione strategica*", McGraw-Hill Companies, Milano, 1990

It is a process of defining the corporate mission, the fundamental objectives of the organization, acting in a long-term perspective and, therefore, identifying the strategies necessary for achieving them. This process involves above all the top management, that is the highest-level managers, who carry out coordination tasks, as they have more information and the authority to impress innovative paths towards which resistances often occur within the company.

Figure 2.0 –The planning process activities



Source: Our elaboration

The first phase, the *Corporate Mission Definition*, concerns the identification of the goals that the company wants to pursue in terms of growth, development and image. It regards strategic objectives that can be qualitative, such as access to new markets, the new customer segments acquisition, an offer review of products and services, their diversification and company reorganization; or with an accounting nature, in terms of corporate profitability, turnover, lower indebtedness.

Moving on with the company's C*urrent Situation Analysis*, it studies the environment in general, but also the specific sector in which the company operates, highlighting the internal strengths and weaknesses. Taking into consideration the external analysis, the attention is focused on cultural, social, political, economic and technological segments in order to understand the real revenue and development prospects. From the analysis of the specific sector in which the company operates, derive information about the level of existing coherence, the trend of products and services demand provided by the company, the prices and the impact of innovation and new technologies on their business and consumers. The internal analysis about the strengths and weaknesses, examines the available resources (material, immaterial and financial), the productive assortment in its qualitative and quantitative composition (quantity of products and their characteristics), the products profitability (the contribution given by each product to achieve the income goals, considering both the long and the short term), the products life cycle (by relating product sales volumes with the age of the same). In conclusion it is identified the company and products positioning in the reference sector, highlighting its competitive advantage/disadvantage towards competitors in terms of the quality of the products offered, prices, innovation and distribution ability.

At this point the *Company Strategies Definition* takes place, with the aim of reaching the company mission, the strategies that concern the company as a whole and considers the characteristics of the reference market and the results of the analyses carried out previously.

Now the *Strategic Plan Creation* is held, a summary document that is divided into:

- a qualitative part containing the description of the external environment and of the company, paying attention to the opportunities and risks present on the market and on the reference sector and, therefore, to the strengths and weaknesses of the company;

- a quantitative part where the economic-financial analyses carried out are described, the results that derive from them are illustrated and, consequently also the strategies and resources chosen for the achievement of the corporate mission.

2.2.3. Programming

Once the mission has been defined through the preparation of the strategic plan, we move on to programming, which allows to *"define the short-term objectives of operating management, in compliance with the strategic objectives and lines of action identified during the planning phase"*[32].

To achieve the corporate mission it is necessary that the action programs are in line with what was established in the strategic planning, moreover, their definition, which allows to transform the strategy into a series of coordinated activities, must involve not only the top management but also the managers of the individual economic units, activating a communication process and creating a widespread dissemination of the mission from top management to the lower levels.

The programming process begins with the evaluation of the program's implementation status in progress, and of possible deviations with respect to what had been foreseen, as well as the generating causes. Once determined the programs of interest, their convenience and opportunities are analysed, assessing the impact they produce on company management in economic-financial terms, and their consistency with the real capabilities of the company in terms of human, technological and materials resources.

[32] Bartoli F., "*Il controllo di gestione nelle piccole e medie imprese*", Franco Angeli, Milano, 2004

This phase is important to carry out the validity check of what is decided during the strategy planning in fact, when the translation of strategies into programs takes place, adaptation problems may arise due to possible inconsistencies between the strategic objectives and the actual capabilities of the organizational structure, causing a review of what is contained in the upstream strategic plan. Moreover, an analysis of the deviation between the expected objectives and the results achieved in the short term can raise the issue about the validity of the strategic objectives of the long-term strategic plan[33].

Finally, in the programming phase the expected revenues and costs, related to the required resources and the expected economic results, will be estimated. The forecasts will flow into the Budget which indicates how to achieve the short-term objectives, and thereafter, it will be used in the analysis phase of the management control instruments.

2.2.4. Management Control

Once the strategic plan and the relative annual plan have been defined, the control will be the essential activity aimed at verifying that the management activity is carried out according to the chosen objectives, strategies, policies and plans.

Management Control is defined as a cross process to the company operating cycle, through which the management guarantee the acquisition of resources and their use in an efficient and effective way, to achieve the company objectives based on a set of preventive and final data, where the former reflects short-term objectives,

[33] Agliati M., "*Budget e controllo di gestione"*, Università Bocconi editore, Milano, 2004

while the others derive from the results of business operations. More precisely, the control is *"that activity with which the executive-board verifies that the management is carried out in an effective, efficient and economic manner such as to enable the achievement of the basic objectives set out in the strategic planning"*[34]. Management control is, furthermore, synonymous of leading, deciding, verifying and directing the company business in a planned and coordinated way.

The efficiency is considered as *"the relationship between the inputs used to carry out the activities and the outputs obtained"*[35], it can be measured in two ways:

- internally: verifying the relationship between the physical quantity of resources and the productive factors used, with the production volumes achieved, indicating the physical and technical performance of the production factors and the implementation of the production processes at the lowest cost;
- externally: throughout the supervision of the price per unit, which depend on the competitiveness of the company in the provision markets and in end ones.

Effectiveness is instead *"the ability of the company to achieve the predetermined output objectives and, it is assessed by comparing the expected outputs with the actual ones"*[36], therefore verifying, through the operational process, if what is outlined during planning and programming phases has been achieved.

Finally, efficiency and effectiveness express the concept of cost effectiveness, or the company's ability to last over time, maximizing the benefits of the resources used.

Other elements that are object of control are: the quality, concerning every aspect of the company activity, and lastly the timeliness that have to do with the timing to carry out activities and processes, where their reduction allows for greater

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[34] Brusa L., Dezzani F., "*Budget e controllo di gestione",* Giuffrè, Milano, 1983

[35] Brusa L., "*L'amministrazione e il controllo"*, Etas, Milano, 1994

[36] Brusa L., *Op. cit*

flexibility, timely and economic adaptability, an essential prerequisite for a successful business.

In the last few decades, the clear separation that occurred between long-term planning and short-term goals has faded increasingly, because it is impossible to establish a fixed long-term goal that breaks up into short-term plans. Moreover, the traditional analysis tools enable to do only an ex-post verification of the results achieved, therefore, inappropriate for a continuous monitoring required in order to implement corrective measures in the shortest possible time. For this reason, a more flexible perspective has been adopted, where the control, in addition to verifying the results achieved, monitors the external environment and the competitors' behaviour.

2.2.4.1. Management Control Objectives

The Management Control general purpose is to penetrate the company management to be aware of it and understand the points it is possible to act on, in order to improve it, raise efficiency, effectiveness and cost effectiveness levels.

In this phase there is the verification and ensuring of the correspondence between the forecasted and realized operations, and the consequent verification of the achievement of the objectives or the necessity for their modification. This concerns a complex activity of checking the results achieved, aimed at acquiring the causes of the various deviations between the budgeted and what is shown in the final balance, therefore the adoption of adequate corrective actions in the event of significant variances. The data comparison must be carried out continuously, so as to notice in time any inefficiencies and deviations from the budget data and put in place the necessary corrective actions in order to reduce the global deviation. The control can be either preventive, simultaneous or successive.

A *preventive control* takes place when the budget is prepared, and the consistency of the budget with the long-term strategic plan will be checked before actions, that could use resources for unreachable objectives, are undertaken or before resources in an unsuitable manner are used.

The *simultaneous control* on the other hand, by comparing the predetermined data in the budget with those referring to the management actually carried out, it verifies the progressive approach to the prearranged final period objectives. The latter is implemented during the operation, when there is still time to make the necessary management corrections.

Regarding the last type, the *successive control*, it is a monitoring procedure applied at the end of the programming period, this form of control requires that the deviation occurs and, later, the correction is executed: the companies based on this model are the ones in which the Management Control is still obsolete.

The first Management Control objective is to persuade individual and organizational behaviours to be in line with the achievement of the corporate objectives, therefore, it is a mechanism for guiding and directing the managers activities.

Furthermore, operational objectives concern the constant monitoring of the activities progress by evaluating the performances and coordinating the different activities both horizontally and vertically.

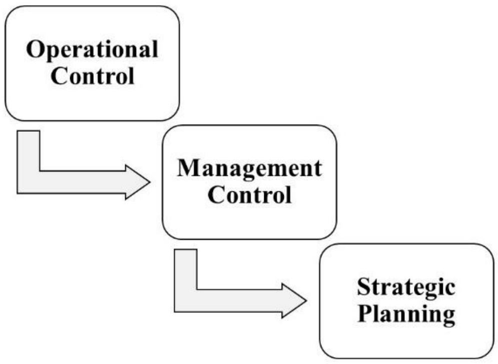
Finally, the most crucial objective of the control activity consists of a social function with reference to a role of guarantee, transparency and accuracy in favour of the company management and all the stakeholders.

2.2.4.2. Management Control Levels

Anthony has proposed the most widespread Management Control scheme in 1965, which classifies the process based on the control activities conducted at various organizational levels. Starting from the top management to the lowest organization levels, it is possible to identify three categories of activity.

However, this model based on a systemic view with a short-term orientation and a vertical dimension, has been overcome by introducing the strategic control with a close relationship among the various levels, that is a tools harmonization and a managerial philosophy oriented to results and to empowerment.

Figure 2.1 – Management Control Levels



Source: Our elaboration

The *Operational Control*, preventive, simultaneous and successive, is the verification activity of the correct execution regarding specific actions for which predefined rules of behaviour exist, its aim is to measure the various operators' efficiency performance, through:

- the definition of authorization mechanisms to guarantee the efficient performance of tasks;
- verification of particular activities performance, that is monitoring activities to identify the authorization mechanisms to follow in carrying out the activities;
- actions accountability, the staff has full autonomy in executing the assigned tasks;
- individual behaviour restrictions, to prevent individuals from doing harmful actions to the company.

At a higher level there is the *Management Control*, which represents all the activities linked to the current management of the company, directed, on the one hand, to determine the objectives to be assigned to the various area managers and, on the other, to verify their degree of achievement. Anthony defines it as *"that process by which managers ensure that resources are efficiently obtained and used to achieve the organization's goals"*[37].

However, the Management Control must face some limitations represented by the use of exclusively financial information, which are not sufficient to have a full comprehension of the company performance, inasmuch it requires technical-qualitative indicators. Moreover, by referring to a short period, the management control does not enable to follow the strategic variables trend, which cover a medium-long period. Finally, the structure tightness impedes a prompt adaptation to the changing environmental conditions.

These limits are overcome by the implementation of the third level of control, the *Strategic Planning*, aimed at proving general knowledge of the company and of the SBAs (Strategic Business Area). This process analyses the corporate strategies in place, with the purpose of verifying the effectiveness of their

[37] Donna G., Riccaboni A., "*Manuale del controllo di gestione*", Ipsoa, Milano, 2003

implementation and providing information necessary for their strengthening or modification. Company performance is determined by comparing the objectives and the strategies achieved in the medium-long term, monitoring the overall trend of internal and external factors on which the company's cost effectiveness depends.

2.2.4.3. Management Control Actors

In a complex and extended control system, numerous and diversified actors operate and the way in which the hierarchical/functional relationships are implemented and the assignment of tasks, depend on the administration model and control that are adopted by the company. In the light of that, it is possible to distinguish different control bodies with the aim of overseeing the activity.

The main control players can be identified in the company top management, that is the general directorate which, having the adequate decision-making levers and the necessary and sufficient responsibilities to manage the resources, deals with the definition of the objectives, the management policies and, moreover, approves or rejects the budget.

The success of the system depends on the management involvement, granted by a good communication within the structure. Only if there are such conditions, that is involvement and communication, management control will be accepted by the various individuals and thus become a tool capable of affecting the people behaviour.

In addition to the top management, the role of the functional areas' managers, who participate in the definition of the objectives and in the preparation of the budget for the areas of responsibility, must not be neglected; and furthermore, the middle managers position, who participate in the control activity without deciding.

Finally, the controller, a staff organ, which designs, develops and manages the system through the detected control information. Summarizing its functions in five points it:

- plans the technical-accounting structure, in particular the budget system and the final one;
- collaborates in the implementation and use of accounting tools;
- verifies the results and analyses the information produced by the deviations;
- collaborates with the management and the HR management, for example to define the rewards system, leadership style, increase training and involvement;
- monitors the external environment and analyses the business situation in relation to the environment evolution.

To carry out these tasks, specific skills are required, such as the in-depth knowledge of the company from an economic-financial point of view, the ability to elaborate, interpret and select data so as to be able to provide the necessary advice to solve problems and also be a source of ideas to simplify management relationships, guarantee flexibility and allow the dissemination of cross-functional and coordination relationships.

Nowadays, the figure of the *Fashion Controller*[38] is increasingly widespread, it has recently been established and is partly different from the traditional controller. First of all, this actor must carry out, as traditional activity, a plurality of tasks such as balancing the activities aimed at controlling the procedures compliance and the quality of the economic-financial data, with those ones aimed at supporting the management in understanding the business phenomena. Within

[38] Bubbio A., Cacciamani S., Rubello U., Solbati M., *Op. cit.*

the fashion sector, in addition, it must play the role of “business driver”, by providing information before and after a task has been performed.

In this new perspective, the main tasks of a *Fashion Controller* are:

- the definition of IT procedures and solutions, which allow the timely and systematic use of the greatest number of strategically relevant information;
- definition of the characteristics of the system, tools necessary to evaluate, formulate and implement the corporate strategy;
- management support in the utilization of the information provided;
- tools arrangement able to encourage and allow methodical forecasts at the end.

The new controller figure must study and organize the way along which the competition will take place, implementing the chosen strategy, after the one realized in the past has been evaluated. Furthermore, it will have to inculcate in the management a permanent orientation towards the future through predictive variables, which allow to point out in advance the evolution of the business situation, for example indicators of the collection’s success in the presentation phase of the same, and simulation models expected to continually provide result projections to whom the company yearns for.

2.2.4.4. Management Control Tools

An essential component of the control information structure is given by the IT elements used to organize and process information and data, consisting of a complex decision-making procedure requiring appropriate technical-accounting tools that represent the economic-financial translation of the objectives and operational programs, allowing the measurement of the actual values and of the deviations.

Therefore, control tools must stimulate a greater awareness about the business reality, operating on two fronts: the internal environment, concerning the proper functioning of the organization and its progresses regarding the objectives; the external environment, with respect to which it must be timely in the perception of the opportunities and threats, and give the most appropriate answers to the company necessities.

The roots of the *Management Control Tools* dates back to 1900s in the large American companies, where the general accounting and analytical accounting systems were aimed at attributing the costs and revenues of the company to individual products, markets and customers. Subsequently there is the diffusion of economic-financial indicator systems of business performance.

In 1920s, the budget technique founded by MCkinsey J. O., is developed and spread, it defines the economic-financial operating objectives and assigns the responsibility to all the organizational areas in which the company is disassembled. The important and successful innovations introduced by this tool are the objectives and the responsibilities, which give companies the opportunity to implement their activities in a more realistic and motivating perspective. The need for a divisional organizational model and, therefore, the creation of responsible organizational units, supported the companies' dimensional growth in the 1930s.

The systems described so far, operate in a short-term perspective, as they focus their attention on the variables and on the operating results, overlooking the long-term problem, especially as regards the investments, totally uncovered.

To provide for this deficiency, capital budgeting systems were spread in the 1950s, aimed at giving greater economic awareness to investment choices, up to the creation of planning systems, around the 1960s, with the aim of projecting the company results not only in the annual budget, but over a wider time period.

The abysmal control system revolution of the 1980s derives from the fact that traditional analytical accounting tools gave distorted information, unable to correctly attribute costs to company processes due to an excessive orientation towards the achievement of the fiscal year result[39]. To overcome these problems, there is the introduction of Activity Based Costing systems, which rely upon the determination of costs for processes and activities.

In the current dynamic, environmental contexts that operate globally, it is not negligible that the company does not pay attention to its competitiveness, in fact, the key objective is embodied in the value creation. For this reason, it is necessary to consider within the fiscal year result, the cost of the invested capital, in order to determine the investment risks. Furthermore, this allows the incorporation into the system, of performance indicators that are predominantly non-economic and financial, which express the competitive quality of the company and therefore its ability to create value beyond the administrative period, such as: customer satisfaction measures, quality and efficiency of key processes, development of employee's skills, level of innovation.

[39] Johnson H., Kaplan R., *"The rise and fall of management accounting"*, Harvard Business School Press, Boston, 1987

Table 1.4 – Management Control Tools History

PERIOD OF ORIGIN	TOOL	SUBJECT	GOAL	CRITICALITY LEVEL
1900	Analytical accounting	Product cost	Price decision Convenience evaluation	Parameters of direct costs attribution
1910	Economic-financial indicators	Balance sheet analysis	Profitability factors analysis Capital allocation among divisions	Retrospective and accounting analysis
1920	Budget and Management Control	Balance sheet Standard costs	Economic accountability of organizational units	Objectives quality
1930	Profit centres and Economic stimulation	Profit sharing Stock options	Entrepreneurial involvement of the management	Short-term results orientation
1950	Capital budgeting	Investment evaluation parameters	Capital allocation among projects	Subjectivity of evaluation inputs
1960	Long-term planning	Multi-year plan	Long-term orientation Financial strategies feasibility	Bureaucratic and deductive approach
1980	Activity based costing	Processes/activities costs	Costs and profitability determination per product Efficiency improvements	Complexity technique
1990	Value based management	Value creation measures	Invested capital and risk accountability Short and long term balancing	Predominant financial orientation
1995	Balanced scorecard	Multi-dimensional performance indicators	Measurement, management and control of competitiveness key variables	Indicators' subjectivity
2000	Business intelligence	Supporting systems of high IT decisions	Alternative simulations Strategic and tactics decisions analysis	Dominance of the technique component

Source: Donna G., Riccaboni A., *Op. cit.*

Now it is time to deeply analyse the technical-accounting instruments that make up the management accounting and that allow to carry out the control phase effectively.

The ***General Accounting*** is a set of accounting records relating to the exchange relationships under the economic and financial aspect that the company has with the external environment, consists of a collection of data used to determine costs and revenues to calculate the net operating income of the company and the financial/monetary movements of the management. The advantage of general accounting lies in its ability to summarize the whole business management, useful for the directorate and external stakeholders that benefiting of it. However, this advantage is at the expense of the promptness of the information availability, given that, to reach the final document, it is necessary to wait for the closure of the administrative period.

To increase the internal cognitive dimension of the balance sheet and transform it into a real control tool, it will have to be analysed in such a way as to provide managers with a more precise idea of the company health status from an economic-financial point of view: that is why, a balance sheet analysis gives the opportunity to:

- draw attention to economic and equity variables representative of management;
- allow the temporal comparison of the balance sheets;
- allow a spatial analysis;
- highlight the relevant elements of the company's characteristic management.

After a reclassification of the balance sheet data, the analyses carried out can be of two types: static by indexes, to analyse the company's asset structure, the medium-long term solvency, the achievement of financial balance in the short term and the profitability, that is the ability to achieve positive economic results; and dynamic by flows, which treats the sustainability of the company over time, that is analysing the company cash flow. In contrast to the analysis by indexes, static and structural, which fails to determine the financial movements of the period and the explanation of the reasons for the changes that occurred within the balance sheet, the analysis by flows aims to highlight and interpret the changes in the company capital and financial position. The general accounting and the budget analysis allow us to record the global final results and to compare them with the estimated ones. However, these are not sufficient to provide decision-makers with that set of information useful for making management choices, to arrange sectoral analyses and for investigating the specific causes of divergence between objectives and final results.

A tool that responds to the managerial need for improvement in the decision-making process is the ***Analytical Accounting***: an operational tool through which a continuous and analytical measurement is given to the process of formation of company costs and revenues, to make judgments of internal efficiency and profitability not considering the company as a whole, but focusing on the centres of responsibility, on individual products or product families. The need to meet specific cognitive needs of the management, justifies the unavoidable division and segmentations of the company management that take place during the analysis of costs and revenues[40]. There are different analytical accounting approach systems, which lead to different cost utilization procedures. In particular the Full costing, which includes all the cost elements that it is considered possible or appropriate to attribute to the products; Direct costing, which includes only the cost elements imputable to products with criteria dependent on cause-effect relationships; or more advanced is the technique of Acitvity Based Costing where we have a transition from product logic to activity logic. While in the first two the cost of the product is calculated by referring to the specific object, with this last technique the activities that lead to the finished product are taken into consideration.

[40] Tessitore A*., "I costi nelle aziende di produzione"*, Isedi, Milano, 1974

The general and analytical accounting are analysed starting from the fact that each company can be represented within a value chain completed upstream with suppliers and downstream with customers. The essential aspects are three:

- economic, concerning the acquisition of production factors and the sale;
- technical, related to processing;
- financial - monetary, concerning payments and cash in.

Considering these aspects, the general and the analytical accounting are integrating and completing each other, in fact the first deals with the economic-financial aspect, with the system of accounting records oriented to the determination of the operating income and the relative working capital, while the latter concerns the technical aspect, depicting the economic reality of the company through a richer and more detailed perspective and information, investigating the dynamics of costs, revenues and economic results by referring to particular objects of interest such as products/services, product lines, processes/activities, strategic business areas.

General accounting and analytical accounting are in any case not sufficient in order that the management can take place according to guidelines designed and planned in advance for the achievement of the company objectives, therefore the information system will be integrated with standards and budgets systems.

The ***Standards*** represent the objectives or the ideal or normal input-output relationships that identify the specific company, values that express in monetary, quantitative and qualitative terms the economic, operational and result characteristics to which the company aspire in order to obtain an optimal management. These constitute an indispensable starting point for a correct definition of budgets, where the connection between company policies, production cycle and economic-financial cycle takes place.

The ***Budget*** is an administrative accounting document that shows the economic-financial results that the company wants to achieve in the following year, determines the short-term management objectives and refers them to the company, comparing them with the results of the general accounting or with data from analytical accounting. *"First of all, the budget is a programming tool. It specifies in quantitative-monetary terms, both at the level of the whole company and of its minor articulations, the objectives to be achieved and the ways to be followed to achieve them, in order to ensure an effective and efficient allocation of productive resources "*[41].

The budget preparation can be top-down, where the documents are arranged by the company management and spread to the lower levels with the advantage of being timelier and having lower costs; however, these involve difficulties from the point of view of employee acceptance, which is why other participatory types have been developed: bottom-up and negotiations. The former is always drawn up by the management, but together with the centre managers so as to have a greater sharing of the objectives; the last type, are those that give more positive results from the acceptance point of view, as they are elaborated through a process of negotiations. The basic characteristics that a budgetary system must present to be successfully implemented within companies are:

- globality, or the involvement of the whole company;
- the articulation in annual and interim periods to have a continuous and constant monitoring of company trends;
- the articulation by centres of responsibility to accurately distribute the identified objectives;
- the economic-financial objectives quantification of the resources and the means.

[41] Avi M. S., *"Controllo di Gestione. Aspetti contabili, tecnico-operativi e gestionali"*, Il Sole 24 Ore, Milano, 2007

The main stages of budget articulation process are the forecast, budgeting, control and reprogramming phases.

Forecast: The starting point is to make a correct forecast of the decision-making alternatives, paying attention to the feasibility of the individual interventions. This fashion companies forecast, for the following year, is rarely re-expression of that of the previous year, it instead arises from a continuous vision of the corporate future leading companies to use a Zero-Based Budget method, which requires a complete reformulation of the forecasts, not making hypotheses starting from a percentage variation of the data of the past but reconsidering each time the basic assumptions.

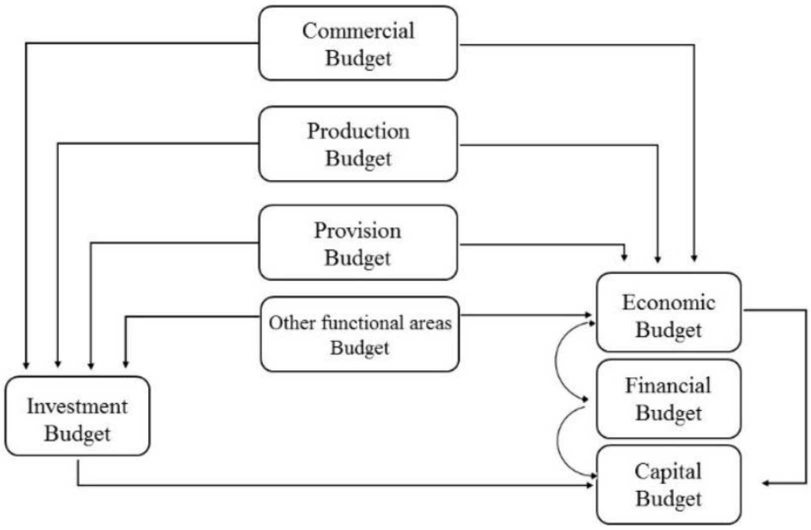
Budgeting: Once the forecast has been established, it will be necessary to carry out its transposition in quantitative terms, that is the budgeting, ensuring a correct correlation between income and expenses, revenues and costs, investments and financing.

Control: At a later time, it starts the control phase aimed at detecting the deviations that have occurred in the budget year and the generating causes. It is a very relevant phase, which links the budget with the analysis of the deviations and makes it possible to identify the causes that led to different results from what had been planned. Many Fashion Companies on the control phase set a range within which the deviations are not considered significant, in order to better focused on those elements with a fundamental role within the company structure.

Reprogramming: Finally, based on the feedback given by the budget for the past year and the analysis of the changes that have affected the external and internal conditions of the company, the forecasts for the next budget year are reprogrammed.

The implementation of this budget process entails, once the general objectives of the plan have been translated into short-term budget goals, the drawing up of *Sectoral Budgets*, which will then be consolidated into summary budgets.

Figure 2.2 – Sectoral Budget



Source: Our elaboration

The first one to be drawn up is the *Commercial Budget*, where quantitative-monetary forecasts are made about sales goals and commercial costs in order to sustain the programmed levels, from which the other sectoral budgets derive. The writing of this first document constitutes the guide for the preparation of the *Production Budget*, which gives indications about the productive activity, that is the planning of production volumes, the industrial costs to support with the aim of ensuring the programmed production levels and information relating to investments with a commercial nature. In parallel, the *Provision Budget* identifies the basic necessities of raw materials to be acquired to feed the production process in relation to what has been planned, the timing of the provision and the choices regarding the management of the warehouse. The arrangement of this budget in Fashion Companies is of major importance regarding the materials used, which can determine an evaluation of costs that are not easy to determine. Finally, the *Budget* *of the other functional areas* concerns the costs and investments to be implemented in the auxiliary centres and in the central structures.

These sectorial budgets are summarized in Synthetic Budgets, which allow to be aware of the investments, the economic-financial and capital needs. The *Investment Budget* is the first synthetic budget that is drawn up and derives from the consolidation of the investments required by the various functional areas of the company for the implementation of the operational programs, highlighting the set of all the short and medium-long term investments required. The *Economic Budget*, shows the composition of the income relating to the next financial year, allowing the overall economic check of the objectives provided by the individual sectoral budgets. The *Financial Budget* makes it possible to verify the compatibility of capital investments deriving from the operating plans and the available internal and external financial sources, normally divided into two prospectuses: financial sources of income and uses, which expresses the requirement for financial security, verifying the compatibility between capital uses and the available financial sources; treasury, which shows the temporal synchronization between cash inflows and outflows. The last is the *Capital Budget*, given by the sum of final balance values and the financial budget, which represents the forecasted capital position that the company will assume at the end of the fiscal year, after the implementation of operational programs and investments described within sectoral budgets.

Together with the budget process we find the ***System of Variations***, which constitutes the control phase, that is the assessment of the final results and the comparison of these with the objectives. It consists in calculating, for each productive resource used, the overall deviation with respect to the target value, measured in economic-monetary terms, subsequently the deviations attributable to the production volume, the coefficient of use or the purchase price.

“Analysing the variations, generally, means putting in place a process aimed at establishing to what extent certain price variations and standard

conditions have had repercussions on the production costs and from what causes the variations in question were produced"[42].

To deal with the considerable amount of information to be managed deriving from the instruments previously listed, the management control uses a ***Reporting System***, which processes the unrefined accounting and non-accounting data, based on the information needs of the various users. It constitutes the set of means of transmission and communication regarding the management information produced for the support of the management processes and for the management control, founded on a series of reports that allow the prompt identification of anomalies and dysfunctions and the consequent reorientation of the management.
"Reporting means a set of relationships intended for the various management levels capable of giving a meaningful picture of company performance in the different areas of responsibility and interest"[43].

This allows company information to be classified with relevance and selectivity, permitting managers to have only those that satisfy their real cognitive needs, in fact, the information subject to an effective reporting, must comply with the following key principles: relevance, selectivity, timeliness and cost-effectiveness[44].

The reporting can be of two types: final, when the results of the actions put into practice are represented; pre-final, when the period results formulated in the same are presented. Between these two types of reporting, in the Fashion Sector, the pre-final one is particularly important. In fact, the activity of these companies is divided into periods during which the main activities take place and for which it

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[42] Coda V., *"I costi standard nella programmazione e nel controllo di gestione"*, Giuffrè, Milano, 1979

[43] Novelli F., Gussago M., *"Controllo di gestione e reporting aziendale"*, Ipsoa, Milano, 1991

[44] Nicolò D., *"Il reporting per segmenti e l'informativa settoriale secondo L'IFRS 8"*, Giuffrè, 2009, Milano

is necessary to prepare the report in order to analyse the deviations before the end of the cycle.

Finally, it has been perceived the need to find control systems that could be adapted to an increasingly dynamic and unpredictable economic reality, in fact, the traditional instruments of control could be useful in periods of substantial stability on the market, this can no longer be enough in the changed context in which most companies have to operate[45].

For this reason, the evolution of the external environment leads the company to use qualitative performance indicators, as the ***Balanced Scorecard,*** which analyses the company's competitiveness by focusing the attention on four aspects that complement each other: on the market, on development and learning, on internal processes and economic-financial results. The Balanced Scorecard will be better analysed in the following chapter.

[45] Lorange P., Vancil R.F., "*Strategic Planning System*", Prentice-Hall, Enhlewood Cliffs, 1977

CHAPTER III: FASHION CONTROL SYSTEM

After a general description of the Management Control System as a whole, it is necessary to analyse it specifically within the High Fashion sector. The fashion system is characterized by notably peculiarities, therefore the management control must be implemented and modelled according to these.

First of all, the external environment, absolutely more dynamic, hypercompetitive, characterized by a strong tumultuousness, by a greater extent of competitors and increasingly demanding customers, has led to the need of implementing a management control in order to support the company's activity and to verify the achievement of the stated objectives. Working by collection, examine the collection performance by season, the importance of customer satisfaction and finally the intangible assets, like the stylistic heritage, are fashion system special features, which make the traditional tools of control mould according to their management requirements, with the need to detect new and more innovative ones that have a future orientation.

3.1. Fashion industries' strategic management process implementation

To determine the architecture of management control for companies working in a specific sector, it is necessary to establish a process of analysis aimed at identifying the company's information needs by developing a situational approach given that the basic necessities differ from company to company and change with time. The "*situational approach*" is an idea developed by Zappa in 1954 stating that a company is not an institution that is always similar to itself, uniform in its development. The company is as different as different are the purposes for which it is made and the factors that work for it or that are used in it, as variable are the environments; above all, the company is as different as different are the events that reveal its throbbing life, as are the various processes in which the events intertwine endlessly, constantly renewing themselves[46].

The application of this approach, in the organization of a programming and control system, starts with the analysis of the external environment considering the economic and regulatory aspects dynamics, going through the investigation of the business characteristics in which the company must operate. From these first results it is possible to highlight which are the critical success factors, or rather, those skills necessary to build, sustain and protect the competitive advantage and therefore the related information needs.

The companies of the fashion system have only recently begun to consider management control as a necessary tool for the management of the company, as in the past they were characterized by very high margins; now instead, given that the success of a company is strongly linked to the brand image, customer loyalty and the effectiveness of advertising campaigns, it is necessary that the control process is implemented also in these realities. The dynamism that characterizes this sector and the prevalence of the stylistic element, is a very complicated reality to intertwine within a particularly rigid and structured strategic control system[47]. In fact, as regards to the formality level of the model, it should be not too rigid, as the creative-emotional soul of such enterprises is hardly suitable to this structure,

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[46] Bubbio A., Cacciamani S., Rubello U., Solbiati M., *Op. cit.*

[47] Albertario M., *"Il controllo strategico nel settore del lusso: il caso Diamond"*, in: "Amministrazione e Finanza", n. 23, 2004

moreover since the contexts in which it operates are strongly disturbed, it is appropriate implementing an absolutely non-formal, flexible and dynamic model.

Furthermore, it is necessary to pay attention to the organizational aspect of the controller and the collaborators activity, for which it is essential to define a programming and control calendar within which the activities to be carried out and their timing are established, using the more appropriates control instruments for each phase based on the life cycle of the product.

Table 1.5 – The life cycle of the programming and management control system in Fashion Companies

Objective	System introduction	Orientation through the system utilization	Dissemination of the control philosophy
Recipient of the information	Top management	Top management and high-level manager	Company management
Controller position	External part-time consultant	Within the administrative function	Staff position
Controller role	Plan and launch the system	Complete the system and discipline the managers	Guarantee the long-lasting effectiveness of the system
Results	Provide the first economic analysis	Timely provide economic-financial data	Provide all the information, also the off-balance sheet ones

Source: Bubbio A., Cacciamani S., Rubello U., Solbiati M., *Op. cit.*

The initial phase of introduction and company manager support focuses more on the analysis of the collection and season economic results, which should be followed by the elaboration of the budgeting process. The controller in this phase is supported by an external consultant who supports and guarantees the functioning of the system and the growth of internal resources that will be dedicated to its management.

In the later stages of development and maturity, there is the implementation of new tools, combining economic analysis with financial analysis and providing for the introduction of other dimensions, such as customers and the sales channel. This will increase the number of recipients of the report, no longer directed only to the top management, but also to the managers of the different areas for which it will be necessary developing specific reports.

Finally, there is a change in the role of the external consultant, gradually replaced by the internal controller, which will no more be subjected to administrative tasks, but will be contextualized in the top management.

The organization of the process can be implemented in a formal or informal way. Using informal systems of control does not affect negatively the successful implementation of the same. Indeed, these systems are perfect for more articulated and dynamic contexts, in which the presence of a too strict and formal structure can be a limit to carry out a proper control process[48]. However, the choice between the two alternatives, depends on a plurality of factors and on the characteristic of a specific high fashion company. In fact, it can be *quality classic oriented* or *fashion oriented.* It should consider the following factors:

- the extent of the risk that characterize the sector;

[48] Garzoni A., *"Il controllo strategico. Modelli e strumenti per il controllo dei processi di gestione strategica"*, Egea, Milano, 2003

- the time that elapses between the decision of the management and its translation in economic-financial results;
- the factors of the sector competitive advantage;
- a portfolio of activities and the nature of the same, in relation with the diversification and the interdependence among each Strategic Business Area.

Sectors with a high degree of risk are easily subject to sudden strategy changes, in this case a flexible model can assure a faster adaptation to environment alteration. Moreover, wider is the time interval between the decision moment and its actual implementation, higher is the probability that the competitive scenario incurs in significant changes. With this hypothesis, the adoption of an informal system guarantees a greater flexibility and adaptability to the system.

Regarding the changeable environments that characterize the high fashion sector, it is essential evaluate the suitability of the strategies at the base of companies' activities. The strategy is built taking into consideration key variables, which depend on hypotheses that could occur or not, or could be valid for the whole implementation period or not. These hypotheses establish that such variables:

- preserve the assigned importance. In fact, if a specific variable will no longer be crucial or if it exhausts its life cycle in advance, it is essential to determine new and different critical success factors;
- generate the forecasted reaction on competitors. A not congruent response to the expectations, require a review of the key variables considered;
- follow the forecasted trend. An invention, an innovation, a new competitor with completely different strategy are occurrence that can change the behaviour of the key factors and, consequently, the necessity of determining new ones or review their role or priority.

It is evident the necessity of an ongoing monitoring of the work environment of the company. The alteration of the specific context originates from a set of factors which can be separated or, sometimes, they merge influencing one another.

Specifically, the main factors are the competitors' behaviour, the technological change, in fact, the fashion sector is characterized by a great impact of the creativity, new materials or new material processing techniques which affect the competitive scenario, finally, further changes can derive from a different regulatory framework which regulates the sector.

By adopting a *foreward-foreward control*, it is possible to create a risk strategic map of the company with the aim of systematically manage the uncertainty of the environment. After having ascertained the consistency of the strategic decisions with the company mission, it is necessary to verify the effective achievement of the strategic objectives, especially the long-term and short-term ones. From this perspective, it's of main importance defining *milestones* in order to establish intermediate objectives. In the end, it is indispensable that the performance indicators possess some basic characteristics as the controllability, measurability and, moreover, they must be imputable to a unique responsible[49].

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[49] Del Castillo A., Scott W.G., *"Nuove strategie di gestione del vantaggio competitivo"*, in: "L'impresa", n.6, 1986

3.2. Fashion industries' cost accounting

After having explained the reasons for which it is useful to implement an adequate management control system in the fashion sector, it is necessary to go in-depth about the management accounting tools that can be used. One of these is the analytical accounting, initially intended as a simple accounting of costs relating to the company as a whole, having the purpose of identifying the cost of the product considering only the internal transformation process, which subsequently takes on a broader meaning by including the entire process of cost detection starting from production, processing to reach the market and therefore the product sales activity.

With the aim of implementing an adequate analytical accounting, it is essential to determine the cost objects to which assign the share of the total costs borne by the company. The dimensions to be considered in the cost analysis are two: temporal and spatial. The first distinguishes the estimated costs and final costs, depending on whether they are attributed to a future period or to an interval of time already passed. The spatial dimension considers, in the other hand, the elementary units into which the synthesis dimension of the enterprise is subdivided.

Furthermore, it will be necessary to classify the costs in direct and indirect, in fixed and variable, in specific and common, in such a way as to be able to attribute them to the object of calculation according to the most appropriate criterion and being able to satisfy the requested requirements.

The distinction of costs in the fashion sector, especially between specific and common, is never absolute, because it depends on the extension of the cost object to which they refer, in fact, the incidence of common costs decreases with the expansion of the object of cost. As an example, considering a product that has a certain share of special costs and common costs and the extension of the cost object increasing passing from the product to the department or to the division, it will be evident that the volume of the special costs increases, up to the extreme when, considering the entire company, there will be only special costs.

Figure 2.3 – Cost object and impact of special and common costs in High Fashion Companies

COST OBJECT	PRODUCT	COLLECTION	GROUP OF COLLECTIONS	SBU	BRAND	COMPANY
NATURE OF COSTS	SPECIAL	SPECIAL	SPECIAL	SPECIAL	SPECIAL	SPECIAL
	COMMON	COMMON	COMMON	COMMON	COMMON	

Source: Terzani S., *Op. cit.*

3.2.1. Object and configuration of the cost

The identification and aggregation of the objects from which to develop the analysis is an important step, since it will affect the configuration of the entire information system with the aim of creating a set of multidimensional information data in which it is possible to browse to find all the information you need to support the control process and measure company performance.

First of all, it is necessary to define the cost object, that is the entity to which to assign the amount of specific and total costs of the company. However, the company as a whole constitutes a summary calculation object used in the general accounting. In the context of management accounting, instead, it will be necessary to identify other partial ones, which are subsets of the company summary object such as: the product, the customer, the collection, the product category, the distribution channel and the geographical area.

To do this, it is essential referring to the two previously analysed dimensions: spatial and temporal. *"The cost objects to be fully identified must be defined both in their extent and complexity (spatial aspect) and in terms of time and duration (temporal aspect)"*[50].

Regarding the first one, the cost object can be a specific activity, a particular processing phase or a single product. Based on the type of cost object, different types of costs can be associated.

Specifically, in high fashion companies the cost object, instead, in its spatial dimension, can coincide with the following elements:

- single product;
- single collection;
- collections' group;
- business unit (SBU);
- brand;
- company.

Concerning the second dimension, in order to correctly attribute the costs to the objects, it is necessary to identify the temporal unit of reference. This choice involves establishing the frequency with which to calculate the different cost configurations. Moreover, it is of main importance considers the moment in which to carry out the cost collection, in this perspective there are estimated costs and final costs. In particular, for the sectorial companies, an appropriate temporal unit of reference is the season, since this unit represents an independent economic cycle.

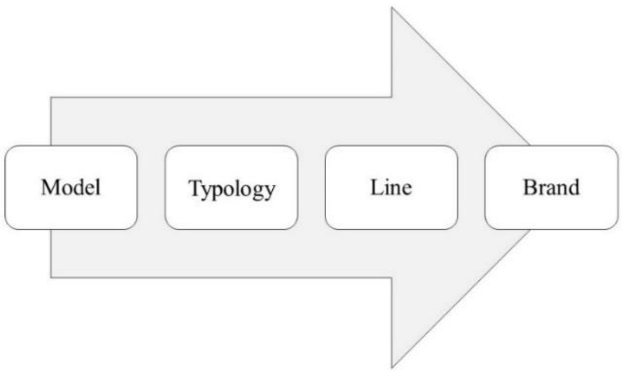
[50] Tessitore A., *Op. cit.*

However, to identify the appropriate objects of calculation, the first step consists in the choice of the elementary dimensions with respect to which it is possible to detect, subsequently, more analytical information, from which the aggregation hierarchies of the elementary data will be constructed and can be of two typology: simple, if a single aggregation logic is used; multiple, if different types of aggregation are used.

The typical elementary dimensions of all companies are the product and the customer, instead, specifically in the fashion system, it is necessary to consider other ones such as the collection, the season and the time.

The *product* is a dimension that can have different variants and aggregations, for this reason it is essential to establish the level of detail in the interest of the analysis. Considering the product-model dimension, it is possible to build a simple hierarchy by grouping the models by product types, which in turn can be the object of aggregations by product line and brand.

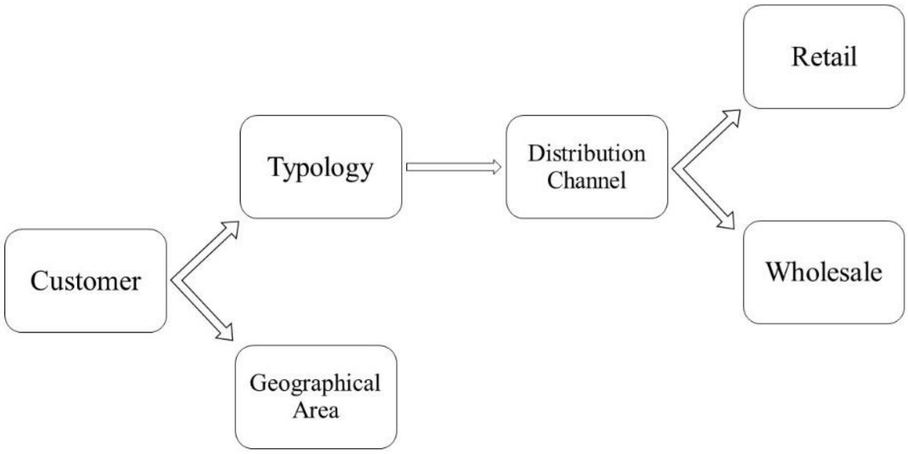
Figure 2.4 – The product dimension



Source: Our elaboration

An additional typical dimension of analysis is the *customer*, it is analysed on the basis of a multiple level hierarchy, starting from the typology, which will subsequently be distinguished in direct or indirect distribution channel and, therefore, further segmented or aggregated on the base of the geographical area of reference.

Figure 2.5 – The customer dimension



Source: Our elaboration

Regarding the specific analysis dimensions for fashion companies, there is the *season*, which can be considered a further level of the product hierarchy. The same reasoning is applicable for the *collection*, bearing in mind the hierarchy level, which is the combination of the line and season.

Finally, the *time*, an indispensable dimension that determines on one hand the need to monitor certain events with a high frequency, as on the occasion of the ordering campaign, on the other hand, within the control system, it is not necessary to have a continuous information gathering, but it will be opportune to identify which are the key moments in which to carry out the analyses.

Starting from the data available for each single dimension, it is possible to cross two or more of the latter, building a more detailed information of a fact and of some specific elements.

To carry out analyses on cost objects, there are support tools, such as *Drill Down* and *Roll Up*[51]. The first, gives synthetic data, deepens the analysis along the hierarchical sequences; the second one, on the other hand, has a reverse function, starting from a level of detail it obtains a general information and a greater aggregation of the data. Two other operations are the *Slice*, which consists in applying a filter on the analysis dimension by selecting one of its elements; the other approach defined *Dice* gives, instead, a subset of data through the simultaneous application of a filter to the different dimensions.

In order to systematize all the information gathered during the analysis of the calculation object and to subsequently take the decisions, it will be necessary to construct a *Map of Information Needs*, which highlights the events to be monitored, the significant dimensions, the hierarchies and the measurement parameters of the phenomena.

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[51] Bubbio A., Cacciamani S., Rubello U., Solbati M., *Op. cit.*

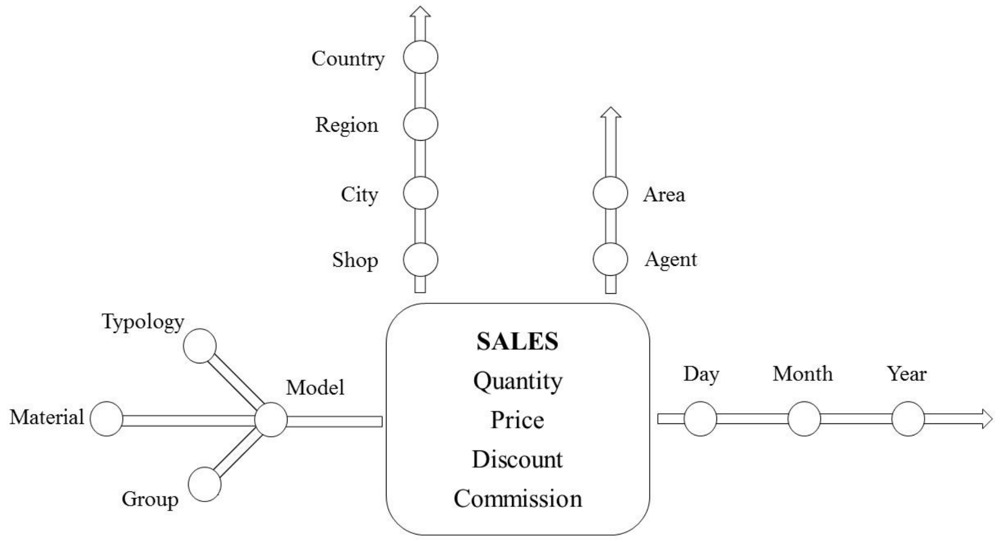
Figure 2.6 – Map of Information Needs

	DIMENSION		PRODUCT		COLLECTION		CUSTOMER		GEOGRAPHICAL AREA			TIME	
FACTS	MEASURES	HIERARCHIES	TYPOLOGY	MODEL	SEASON	COLLECTION	CHANNEL	CUSTOMER	AREA	COUNTRY	REGION	YEAR	MONTH
ORDERS	NUMBER												
	QUANTITY												
	VALUE												
	…												
SALES VOLUME	QUANTITY												
	VALUE												
	BUDGET												
	DEVIATION												
	…												

Source: Bubbio A., Cacciamani S., Rubello U., Solbiati M., *Op. cit.*

Furthermore, it will also be possible to construct a *Dimensional Fact Model*, a simple graphical representation model that allows to visualize the information needs and the peculiarities of the object of analysis, linking the different temporal and spatial dimensions related to it, through the construction of hierarchies.

Figure 2.7 – Dimensional Fact Model



Source: Bubbio A., Cacciamani S., Rubello U., Solbiati M., *Op. cit.*

After having defined the different typology of cost object dimension to take into consideration in order to correctly allocate the company costs, it is essential to choose the configuration cost that is intended to adopt. There are different options:

- material costs and direct labour, composed by the sum of the direct costs of industrial nature. Regarding the high fashion sector, it means allocate costs concerning the raw materials and semi-finished product employed in the realization of the product as for example leather, buttons, zippers. Moreover, there are costs related to the direct labour, required to complete the final product and attributed to the single product;

- production cost, which derives from the sum of the previous one and the indirect costs[52] of industrial nature, that are those ones not directly attributable to the object but related to the productive activity. For example, the electricity or heating, the indirect labour, the depreciation of machineries, the development costs of new products and collections;
- overall full cost, obtained summing the production cost and the indirect costs of industrial nature, that are those ones concerning ancillary functions such as the distribution, the administration or the legal department;
- economic-technique cost, that is the sum between the overall full cost and the figurative financial costs, in other words, costs related to the remuneration of the entrepreneur, the figurative rental and the interests that the entrepreneur would receive if instead of investing in the company he would invest in different activities.

3.2.2. Cost's typologies

Once analysed the elementary dimensions and the configuration that the cost object can take, it is possible to identify within the fashion system three main types of costs on which to focus the attention: collection, communication and variety.

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[52] *"...direct costs are costs of productive factors in which can be measured, in physical quantities and in monetary value, the contribute in obtaining a specific quantity of product; the indirect ones are productive factors costs in which that measurement can be approximated"*

Catturi G., *"Teoria e prassi del costo di produzione"*, Cedam, Padova, 2000

Collection costs

They derive from the long and complex process that must be implemented before determining the collection to be launched on the market. The process that must monitor these costs, is divided in fundamental phases such as the *definition of the guidelines*, where the sales analysis of the previous season takes place, then the preparation of the *collection plan*, where the collection is planned in greater detail, and finally the phase of *executive development*, an operational activity that must be studied in depth to detect the costs to be analysed.

The executive development of the collections can be divided into sub-phases, at the conclusion of which there will be the launch of the product on the market.

- The first of these sub-phases is the *stylistic ideation of the articles*, which defines the main contents of the collection, that is the delivery and preparation of the sketches of the designers, as well as the examination of the fabrics and materials presented by the suppliers[53], characterized by a high creative content to be reconciled with market needs.
- Moving on with the *realization and examination of the prototypes* with the use of the simplified bill of materials, where a single size and a single colour is considered to calculate the costs to bear aiming at producing the sample.
- The next phase which consists in the *realization of the sample and the production of the articles*, is focused on the preparation and identification of a provisional list, in order to prepare a more detailed bill of materials[54], where, unlike the previous one the materials, the production methods and the codes of the individual articles will be identified.

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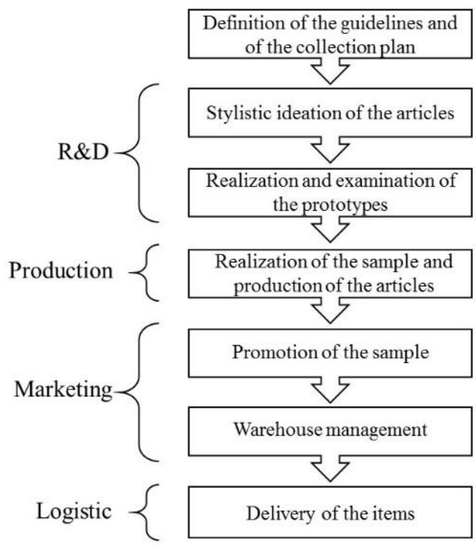
[53] Abernathy F. H., Dunlop J. T., Hammond J.H., Weil D., *"A stitch in time: lean retailing and the transformation of manufacturing – Lessons from the apparel and textile industry"*, Oxford University Press, New York, 1999

[54] Ferri Mala A., *"Introduzione all'organizzazione nell'industria dell'abbigliamento"*, Tecniche Nuove, Milano, 1997

- The *promotion of the sample* regards the launch of the product on the sales network during fairs, fashion shows and showrooms.
- The *warehouse management*, to ensure the movement of samples required by the promotional activity and their shipping.
- Finally, the *delivery of the items* through the use of the logistics area and the related staff.

The complex process of collection definition highlights a series of activities and costs associated with it, which are only partly directly attributable to the individual products. In this perspective, the optimal solution to have a correct definition of collection costs is to follow a logic based on activities, by associating to each phase the resources consumed. In this way, it is possible to distinguish the directly attributable costs and indirect ones, for which a coefficient is identified with the aim of distributing the consumption of resources between the different activities.

Figure 2.8 – Value chain of the collection



Source: Our elaboration

Communication costs

Regarding the communication costs, it is necessary to make an introductory remark on the current competitive context. Today, differently from what happened in the past, the attention moves from the production to the final customer[55]. In fact, the essential prerequisite for companies is the achievement of productive efficiency, therefore, the challenge concerns marketing policies, the ability to attract customer attention and interpret their needs in the best possible way. It is about communicating the added value of the company by changing the way it operates, no longer focused on production but on customer satisfaction. Communication in this context plays a fundamental role.

A great communication strategy is essential for creating and maintaining the brand image, that is the whole system of the company relations with the internal and external environment. The company communication can be differentiated in:

- commercial, to make known to the public the realized products and their ability of satisfying the community needs;
- managerial, to improve the relations among who is involved in the company management;
- economic-financial, with the aim of promoting the future trend and perspectives of the company.

Regarding this context, the analysed costs are the commercial ones and going deeply with respect to the high fashion sector, it can be stressed the importance of some of them.

Fashion companies bear huge costs for marketing activities related to advertising in the press on newspapers, magazines and sector magazines, for billboards and on public transport, which allow to reach a large number of new

[55] *"Consumers leads than reacting to sales calls"*

Kaplan R.S., Norton D.P., *"Strategy maps. Converting intangible assets in tangible outcomes"*, Harvard Business School Press, Boston, 1975 potential customers as they are positioned in strategic points of the city, the only defect is that they are particularly expensive. Another typology is the communication through the radio, television, cinema and banners on web pages, even if they can diminish the exclusiveness of the company image, in fact, very often the decision is to resort to such type of advertising for consumer products. Finally, depending on the level of segmentation of the companies, costs are borne for fashion shows, events, catalogues, visual merchandising and celebrity dressing.

The marketing costs, whatever type considered, are always substantially fixed, which affect the potential volume of sales and therefore, even if indirectly, the production. Furthermore, they are also specific[56] when related to the launch of a new product or a new line: as the costs for the advertising campaigns in magazines or posters can be considered fixed, as they advertise the brand and in addition the specific product; those relating to the celebrity dressing or to the runway shows for the launch of a new clothing line, can be considered in part specific, because if the collection was not launched, these costs would not be borne.

Variety costs

Finally, variety costs, which are particularly relevant for fashion system companies in the current global competitive scenario. From the point of view of the collection there are three drivers of the variety[57]: the dimension that includes models, sizes and colours; innovation that results into new products and processes and, finally, the articulation that derives from the variety of demand and the internal conditions of the manufacturing company.

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[56] Speziale M. T., *"I costi della comunicazione nelle imprese dell'alta moda"*, in P. Miolo Vitali, "Problemi di costing in diversi contesti aziendali", Pisa University Press, Pisa, 2006

[57] Napoleoni E., *"L'analisi dei costi della varietà nelle aziende del settore moda"*, in: S. Terzani, "Problematiche gestionali e di controllo nelle imprese dell'alta moda", Quaderni di dottorato 12, Il Prato, Firenze, 2006

Knowing that the total costs of the product are given by the sum of the costs previously described, the companies must reach the optimum point as much as possible, where the mix between the volume for a single item and the variety minimizes the average unit costs. For all these costs, the necessity of implementing a calculation method based on the activities is fundamental, since considering the products for their attribution, through the volumetric distribution, would be difficult and inappropriate to provide a true picture of the resource consumption: for this reason, it is advisable to use an *activity-based* allocation system.

3.2.3. Cost allocation

After having described the role of the analytical accounting in the fashion system and the various cost classifications, it is necessary to investigate which are the methods of cost allocation that are mostly used in order to determine the cost of the product and then to monitor the business management.

3.2.3.1. Direct Costing

The *Direct Costing* system considers the variability as a basic driver and takes into consideration the "activity costs" and the "period costs". This approach is based on the concept of variable cost, which comprehend all the variable costs that vary with the realized productive volume: *"the basic logic is that it would be* *useless to elaborate full cost information, attributing to the object of calculation, parts of indirect costs according to arbitrary methodologies. It is more appropriate to focus the attention exclusively on objectively attributable cost elements. The main obstacle in using this method lies in the separation of fixed and variable costs which often involves approximations and simplifications of the reference reality* "[58].

This methodology has a particular utility concerning the high fashion companies. In fact, is of main importance calculating the impact of variable costs of a product realization to evaluate the economic affordability, since, if the market price does not cover the variable costs, the production of a new line or product is immediately discarded.

Considering companies *quality oriented* that focus the attention on the quality of the materials, the variable costs are significant and change with the production volume, for this reason using the Direct Costing is ideal. On the other hand, the *fashion-oriented* ones, have a greater amount of fixed costs.

However, in high fashion companies is effortless to cover the variable costs thanks to the high prices of fashion products on the market, but, on the other hand, covering the fixed ones is too difficult. According to this method, in calculating the cost of the product only the variable/activity costs will be attributed to it, since they are considered yearly operating costs, excluding the fixed/period costs insensitive to changes in production activity levels.

In this case, in order to carry out a first management control on company activity, a differential analysis is implemented, which through the contribution margin, given by the difference between revenues and variable costs, highlights the contribution that the object calculation provides to the company for the coverage of fixed costs. Subsequently, it is evaluated the incidence of variable costs for the realization of a product to verify its economic convenience, so that, if the market

[58] Mucelli A., Moretti P., "*L'analisi della gestione aziendale. Controllo dei costi*, *budgeting, reporting e analisi degli scostamenti, Activity Based Management"*, Esselibri, Napoli, 2003

price fails to cover the variable costs, the hypothesis of starting production is immediately set aside.

3.2.3.2. Full Costing

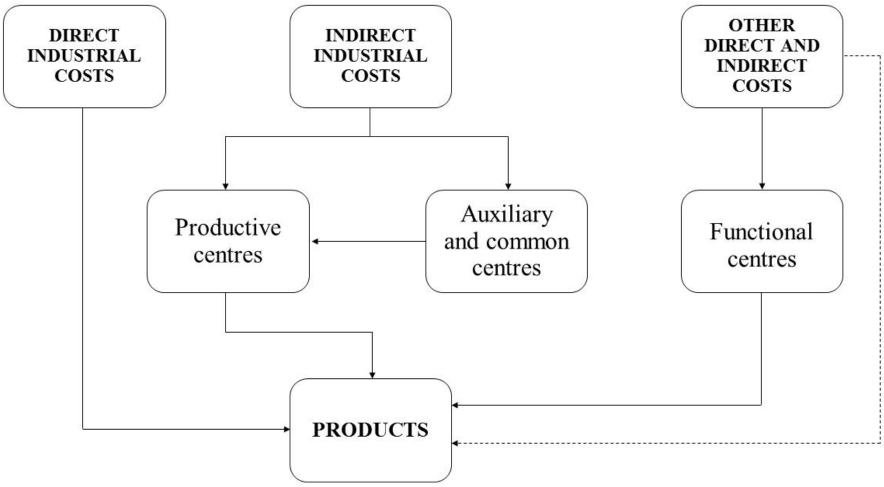
This method is the most popular one among the companies, since it meets the "incorporation logic", where all the borne costs contribute to determine the full cost of the product. *"The goal of this cost calculation method is to determine the cost configurations, usually of product, as complete as possible. This involves the attribution of all the cost's elements to the object of calculation, regardless of whether they are classifiable as variable or fixed costs, special costs (direct) or common ones. The full costing is given by the sum of those cost's elements"*[59].

Based on this general principle, four main phases can be identified, in the process of assigning costs to products:

- identification and allocation of direct industrial costs;
- determination of a cost centre plan for the allocation of indirect industrial costs;
- construction of an adequate system of distribution for the allocation of indirect industrial costs on products;
- creation of a plan for functional cost centres and a set of distribution systems for the allocation of indirect non-industrial costs.

[59] Bubbio A., *"Contabilità analitica per l'attività di direzione"*, Unicopli, Milano, 1989

Figure 2.9 – Costs allocation process



Source: Terzani S., *Op. cit.*

Regarding the high fashion companies, the *direct costs* are divided into two macro-categories, fabric and processing costs, for the calculation of which the information can be deduced from the bill of materials.

For the *indirect costs* it is necessary to construct a cost centres plan divided into productive, auxiliary, common and functional, in order to be able to allocate the costs to the centres that use these resources and, subsequently, allocating them on the final product. The construction of the cost centres plan includes, within the productive ones, the cutting, assembly, ironing and packaging phase to which the costs related to the depreciation of the machinery refer.

Together with these centres, there are the *auxiliary* ones, which group ancillary production activities such as collection development, quality control, machinery maintenance, warehouse and transport. In the allocation of these costs there are difficulties regarding the attribution of the costs of the prototypes not selected for production, where it is possible to decide whether to allocate them at the time of utilization, or to allocate them indiscriminately to the items; usually among these alternatives the most commonly used solution involves charging them, instead of to the individual processing steps, to the product directly. Regarding the quality control, it is important not only to charge those costs that concern the staff, but also those related to the restoration of defects and the training of the personnel. For the maintenance activity a cost allocation criterion is used based on the number of interventions performed or the hours used; while, considering the warehouse, the criterion used is based on the number of movements that have been made. Transportation costs include vehicle depreciation, insurance, fuel and personnel costs and a conventional allocation criterion is used, such as the number of hours of direct labour.

Moving on to the *common cost* centres, these concern the costs of the entire production process, such as electricity, auxiliary material and production manager salary, where the most commonly used distribution system is the number of hours the machinery operates and the turnover.

Finally, *functional cost* centres concern functions different from the production, such as administration, commercial and financial activity[60], where conventional distribution systems are used, as for example the sales price, turnover, single product profitability and specific investment costs.

[60] *"Those elementary units of the structural organization that carry out their activity outside the productive area"*

Nati A.M., *"Costi di produzione e decisioni aziendali"*, Cedam, Padova, 1989

Figure 3.0 – Allocation overheads process on cost centres

COST CENTRES	PRODUCTIVE CENTRES				AUXILIARY CENTRES					COMMON CENTRES			FUNCTIONAL CENTRES			
COST ITEMS	Cutting	Assembly	Ironing	Packaging	Collection Development	Quality Control	Machinery Maintenance	Warehouse	Transportion	Auxiliary Materials	Electricity	Production Manager	Commercial	Administration	Finance	Taxation
DIRECT LABOUR																
INDIRECT LABOUR																
SALARIES																
ELECTRICITY																
FUEL																
AUXILIARY MATERIALS																
MAINTENANCE																
DEPRECIATION																
ADMINISTRATIVE EXPENSES																
COMMERCIAL EXPENSES																
GENERAL EXPENSES																
TOT. BEFORE ALLOCATED OVERHEADS																
FROM COMMON CENTRES (1)										1	1	1				
FROM AUXILIARY CENTRES (2)					2	2	2	2	2							
TOT. POST ALLOCATED OVERHEADS																

TO PRODUCTS

TO PRODUCTIVE CENTRES

TO PRODUCTS

Source: Our elaboration of: Terzani S., *Op. cit.*

3.2.3.3. Activity Based Costing

In addition to the development of techniques and the progressive change in the costs of industrial companies, there has been a change in the method of calculation of the latter. In fact, in the past, the standardized productions provided for a widespread recourse to labour and a greater incidence of direct costs, by using a single distribution system based on machinery and direct labour hours (*plantwide overhead rate*), while nowadays, companies find themselves operating in a competitive context at a global level which involves a mechanization of work, greater complexity of the production process and therefore an increase in indirect costs.

In the fashion sector these changes have a greater impact: even though there is a preponderance of direct costs due to specific production processes for unique and high-quality products, fashion companies are affected by a strong incidence of indirect costs such as marketing and the development of the sample collection[61].

Consequently, it was highlighted that traditional systems, using volumetric distribution criteria, attributed most of the indirect costs to goods made in larger quantities, a concept that loses its validity in fashion system companies, which present a strong customer orientation and indirect costs related to the variety of the offer. For this reason, there has been a movement from a functional perspective for centres of responsibility to one focused on the activities that are carried out.

The principles of the *Activity Based Costing* are then applied, where the basic assumption determines that it is not the products that absorb the costs, but

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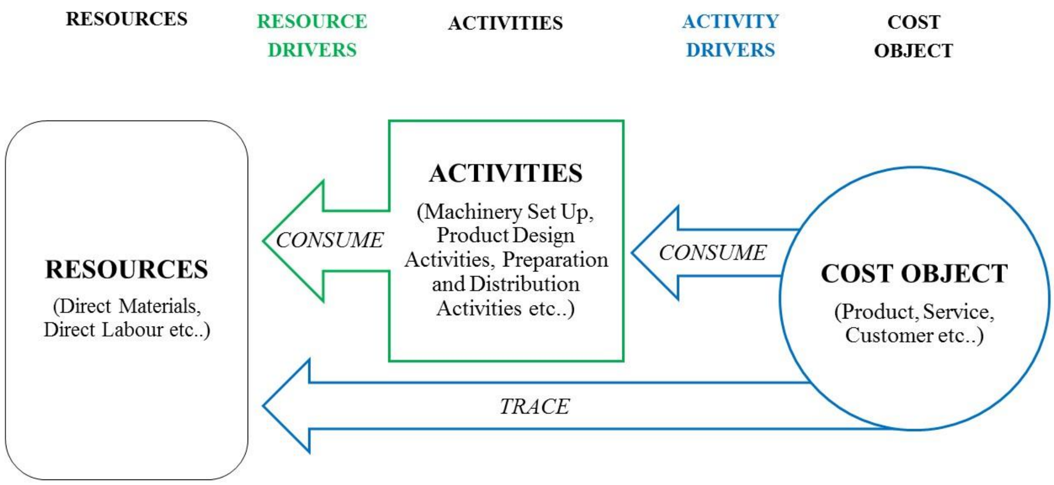
[61] *"In companies where the majority of costs are in the marketing or planning, it is worthwhile using different methodologies (with respect to the full costing), such as the one for activity"*

Lizza P., *"Il controllo di gestione per l'analisi e il miglioramento della performance aziendale"*, Giuffrè, Milano, 2004 rather the activities that generate costs through the consumption of resources. This method generates *overhead costs* that are non-production and indirect production costs, by identifying the main company activities that employ general resources. The first goal is represented by determining the total "cost object" as close as possible to the real resource consumption, it does not include only product and services but, for example, also market and customers. The cost objects are seen as consuming activities and the event that causes the consumption is the "activity driver". Even the implementation of the activity driver consumes resources to work, for this reason they are said to be "resource drivers".

Figure 3.1 – ABC Logic



Source: Our elaboration of: Skousen C. J., Walther L. M., *"Process and Activity Based Costing: Managerial and Cost Accounting"*, Published on "bookboon.com", 2010, https://bookboon.com/

From the perspective of management control, this method makes it possible to highlight the causes that determine the cost levels, to identify the trade-off that operates within the organization, to develop awareness towards the supplier and the customer and finally to identify and evaluate the movement of data and information, in such a way as to be able to act consciously on the sources of competitive advantage.

The management by processes is determined within the company, where the control phase moves from a logic based on results to the one based on the management of the causes of the results. The focus is no longer on the effects, but on the monitoring of the company activities in order to take promptly corrective actions to achieve the predetermined objective.

In order to implement an ABC system, it is necessary to distinguish different phases (Figure 3.2):

- mapping of the main company activities and creation of activity centres;
- attribution of costs to the objects, or to activities throughout the appropriate *resource driver*;
- overturning of costs attributed to centres over cost objects throughout the *activity driver*[62];
- arrangement of the report for the management.

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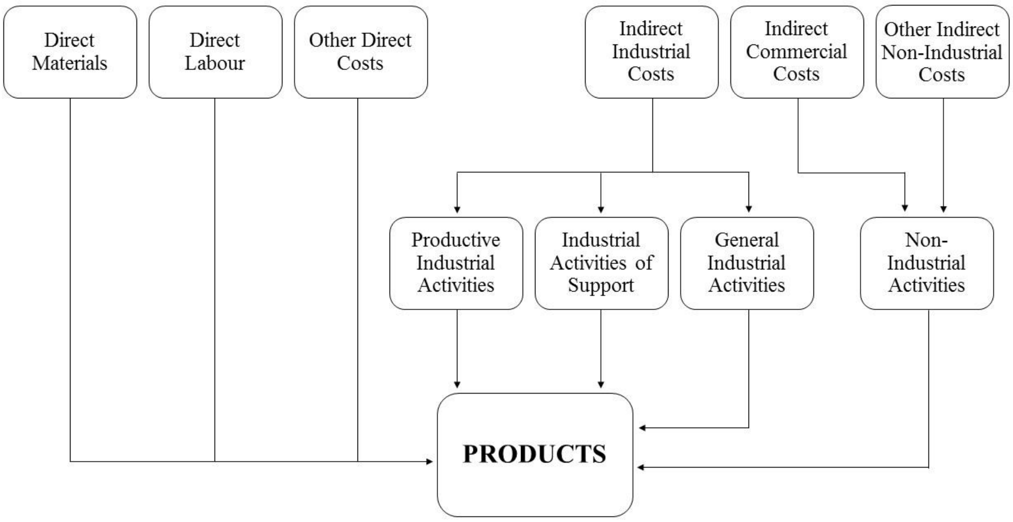
[62] *"The activity driver measures the use of activities regularity and intensity by the cost object and they represent in this sense the activity output"*

Cinquini L., *"Strumenti per l'analisi dei costi*, *Vol I: Fondamenti di cost accounting"*, Giappichelli, Torino, 2003

Figure 3.2 – Full cost calculation of a product with the ABC logic



Source: Brusa L., Zamprogna L., *"Pianificazione e controllo di gestione. Creazione di valore, cost accounting e reporting direzionale: tendenze evolutive"*, Etas, Milano, 1991

The application of the Activity Based Costing method firstly determines the need to carry out a *mapping of the activities* so that the characteristics of the products, the needs of the customers and of the sales channels become a formalized and shared patrimony useful to manage costs. In fashion companies, in order to map activities, it is necessary to pay attention to the season which is the fundamental element to manage with the aim of achieving the control's objectives.

At this point, it is possible to distinguish the following macro-activities: purchases by collection, creation of the collection, presentation of the pre-collection, presentation of the collection, cost sheets elaboration, price list elaboration, acquisition of customer orders, purchases for the production, provision of external laboratories, production, shipment, distribution of the items, invoicing, cash in.

It is of main relevance to group those activities in *activity cost pool*, based on some criteria such as the closeness of the developed activities or the homogeneity of the costs.

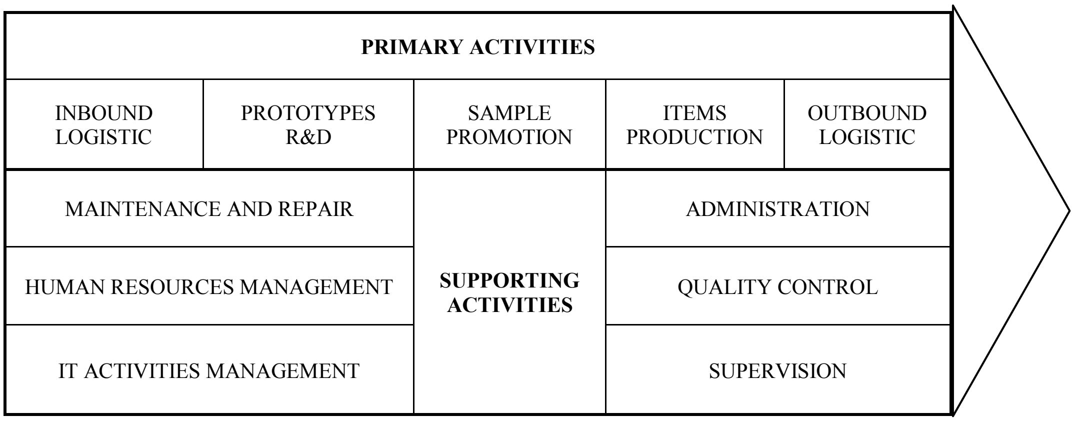
In order to map the specific activities of the high fashion sector, it is necessary to start from the general approach of the *Porter's value chain*[63], making a distinction between the primary and supporting activities.

The primary activities are: the inbound logistic, prototypes R&D, sample promotion, items production and outbound logistic. Sometimes, regarding the "items production", the company can make use of the subcontracting and, consequently, the latter will not be part of the primary activities. Moreover, the company can manage the distribution with its own sales points or entrust the management to third parties, in this way the concerned activity will have a marginal relevance.

The supporting activities, in the other hand, are: maintenance and repair, administration, human resources management, quality control, IT activities management and supervision. The only activity to focalize on is the "IT activities management", where a key role is carried out by graphics software that comprehend the traditional IT costs, but also the specific costs for the items and prototypes creation.

[63] Porter M. E., *"Il vantaggio competitivo"*, Einaudi, Torino, 2004

Figure 3.3 – Activities mapping throughout the value chain



Source: Our elaboration

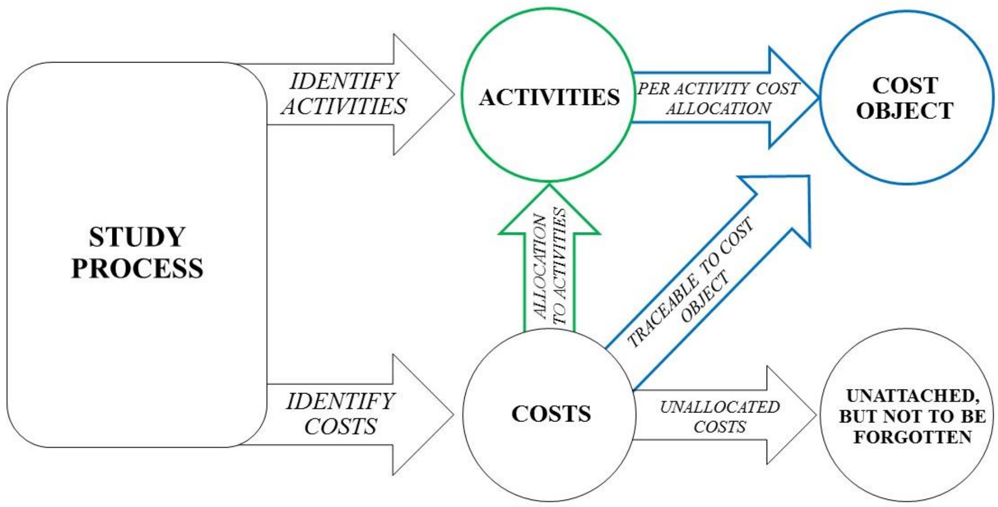
The second phase concerns the *attribution of costs* to the activities in order to determine the full cost for each of them, by choosing the most appropriate activity centres structure.

Finally, the *cost driver* identification, that are parameters able to express the consumption of the activities of each centre regarding the final cost object.

In conclusion, it should be highlighted the existence of some tools useful to support the Activity Based Costing management. One of these is the *project management* techniques, where each season represents a product and must be the object of planning and control, together with the Gantt's graphs, which link the activities in a logical sequence of inputs and outputs, identifying the potential critical phases, the negative effects and therefore the possible solutions to be undertaken. Then, a *cost sheet* is drawn up divided into three macro-areas: the specific product costs, objectively attributable to it, such as those relating to raw materials and manufacturing; the specific product/customer costs to be attributed to the customer with reference to the related product, such as the commercial or fixed costs of the service activities requested by the customer; the common product costs, or the fixed costs attributable to the company.

Moreover, in the fashion sector, a mixed method is used to calculate costs depending on the object analysed, this is called *Activity Based Traceable Costing*. For example, considering the activities that generate costs through the use of available resources, if the object of analysis is the product it will be possible to make a distinction only between fixed and variable costs applying a direct costing method; while in the other hand, taking into consideration the customer, it will be possible to identify, in addition to the variable costs, specific fixed costs linked to particular activities that it requires, thus it is possible to apply a traceable costing technique.

Figure 3.4 – Steps to develop an Activity Based Traceable Costing



Source: Our elaboration of: Skousen C. J., Walther L. M., *Op. cit.*

As a result, it is possible to review the abovementioned steps of the ABC method and enriching them:

- studying processes and costs;
- identify activities;
- identify traceable costs;
- assign remaining costs to activities;
- determine per-activity allocation rates, using the cost pool;
- apply costs to objects.

At this point a *modular profit and loss account* can be implemented, which assigns the variable costs to the calculation object, then the specific fixed costs and finally those relating to specific activities, progressively determining three contribution margins, which highlight the contribution that the object of calculation provides for the coverage of fixed costs. Considering fashion companies, where many activities identified at the time of mapping are intended for customer acquisition, in order to maintain contact with them and provide them with a wide range of services, this gives the possibility to easily attribute these activities to the customer and therefore going to build profit and loss account per customer.

Initially it is observed that the absorption of resources takes place firstly by the primary activities, closely related to the creation and marketing of the product, then those supporting activities are identified, which can affect both product costs and costs for the customer management.

3.3. Fashion industries' budget control

Another important information tool of the management control is the *Budget*, short-term translation in quantitative-monetary terms of the content of the corporate strategic plan. Within the management control process, it is considered a key tool, as for its construction it requires the formulation of the objectives that allow comparison with the final data and thanks to the analysis of the deviations it will be possible to identify the causes and responsibilities of the differences that may emerge.

These objectives must be[64]:

- *consistent*, in line with what was agreed in the planning session;
- *instrumental*, that are intermediate stages for the achievement of the predefined strategy;
- *short-term*, that involve a period of one year or of its fractions.

Moreover, the need to set short-term goals that are reasonably achievable, and periodically checking the results achieved, is a problem of vital importance in the management of the modern enterprise[65].

In the companies of the fashion sector, the arrangement of the budget is influenced by the operational logic, as with regard to companies operating with *"production on order"* the budgeting activity is less exposed to errors even if it is drawn up before the acquisition of orders, because it will be possible to make changes on the data, based on actual orders arriving before the start of production.

For *"ready to wear"* companies, on the other hand, there is a higher risk in terms of unsold and related to the management of the budget, because it is based on

[64] Berti F., *"Il sistema dei budget aziendali"*, Cedam, Padova, 1995

[65] Aloi F., *"Il Budget e il controllo di gestione per le PMI"*, Ipsoa, Milano, 1997

forecasts on which it will not be possible to make changes since the order reception phase is following the start of production.

Another peculiarity of these companies is the subdivision of this instrument into under-budget, in order to satisfy the need to have available forecasts characterized by a greater detail. In this perspective, the budget of the two spring/summer and fall/winter seasons is used, which are further subdivided into the collection budgets and then divided into budgets for each product. In addition to this articulation, the budgets of the various functional areas of the company are drawn up in parallel to have the final coordination within the master budget.

3.3.1. Budget typologies and articulation process

"A budget can be essentially defined as a plan as a function of an objective…or better defined as a programming and control system"[66]. In fact, it allows to highlight the whole deviation between what has been programmed and what has actually been realized, moreover, it allows to understand the causes of such deviations and the business areas involved.

This tool pushes the marketing to sell what has been conceived and the production to realize what can be allocated on the market. Furthermore, for it to succeed, it should be accepted by all the subjects engaged in the company life, first of all the budget committee, that are those who dictate the guidelines for the implementation of this tool.

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[66] Jones R. L., Trentin H. G., *"Il budget: strumento di programmazione e controllo"*, LI/ED, Torino, 1972

In this sense, there are different management styles which lead to the creation of three main budget typologies:

- *imposed budgeting*, developed by the top management and infused to the lower levels based with a *top-down* logic. This typology of budget presents a lot of advantages such as quickness and less costs, but on the other hand, it can be difficult to accept and also it could propose unrealistic objectives, so that unattainable;
- *participatory budgeting*, elaborated by the top management together with the managers of each level. Here there is a *bottom-up* logic, which considers the sharing of the objectives with the organizational structure members. However, there is the risk of realizing too sectoral documents due to the managers inability of having a global vision of the company;
- *negotiated budgeting*, it is the halfway solution. Unfortunately, the slowness, the costs involved and the difficulties in reaching an agreement, made easier methods preferable.

Four characteristics should be analysed and considered in order to implement a successful budgetary system. Firstly, the *globality,* in fact, the budgetary system should involve the whole company and not only each functional area. Then, the *articulation in annual and interim periods* is necessary in order to better monitor the possible deviations and suddenly remedy during the period. For this reason, especially in high fashion companies, there is the drawn up of the annual budget that, consequently, will be processed monthly. Finally, the *financial-economic estimation of the objectives determined in a provisional moment*, specifically its ability to express in numbers the objectives and, moreover, the resources and means employed to achieve them. *"It is shown with the method the willingness of pragmatism that it hadn't always been respected in the past"*[67].

[67] Meyer J., Launois S., *"Il controllo budgetario. Teoria ed esercizi"*, Franco Angeli, Milano, 2006

With the aim of contextualize the budgetary system in the high fashion companies, it is essential to establish the steps to determine the objectives and their effective realization. The time sequence is the following:

Prediction

The first step in the budgetary process is the correct formulation of the business prospects, regarding the feasibility of each intervention and on the real willingness of realize what has been previously established. In order to avoid that, the current budget is a re-expression of the one of the previous year, consequently, a *zero-based budget* methodology should be implemented, which consists of a reformulation of the forecasts justifiable with strong scientific findings.

Budgeting

This phase regards the translation of the forecasts in budget documents, in order to measure the predictions based on the objectives, means and resources useful for that purpose. The document, throughout the master budget and the sectoral ones, should translate the predictions in monetary elements bearable by the whole structure.

Control

The company is able to detect the deviations of the budgetary year and to search for the causes. The choice of the budgetary system should be as much coherent as possible with the company's chart of accounts and, at the same time, the latter has to adapt to the requests of the budgetary procedures, in order to adapt the same chart of accounts to the necessities of the management control. The main difficulty is during the deviations' analysis, especially for the high fashion companies. In fact, with the aim of focus only on the more significant differences, the majority of the companies determine a "range" within which the deviations are not considered substantial.

Reprogramming

On the basis of the obtained feedback from the budgetary system of the past year and the potential deviations deriving from the external environment and internally of the company, the forecasts for the following year and the corresponding reprogramming action are determined.

3.3.2. Preliminary documents for the budget preparation

In drawing up the budget of a high fashion company, it is necessary to pay particular attention on the timing of the activity. The latter takes place in advance compared to traditional companies, in fact it is carried out in February rather than in October, this because in that month the orders of the spring/summer season will have already been collected and the processing activity for the autumn/winter season has begun, therefore it would determine an inefficiency of the same.

In February, the *management budget* is drawn up, a simplified version with respect to the company one, since only the economic effects of the decisions adopted are analysed and it is not necessary to make a detailed forecast of all the components. In fact, the company is not aware of the real composition of the collection, so it is essential to identify only some general objectives, such as turnover, contribution margin, fixed costs, and define the actions to be taken to achieve them.

Prior to the preparation of the high fashion companies' budget, attention must be focused on some essential documents that set the guidance to follow and, moreover, that define the planning and programming activities to undertake.

Figure 3.5 – Documents that define the planning and programming activities in the high fashion companies

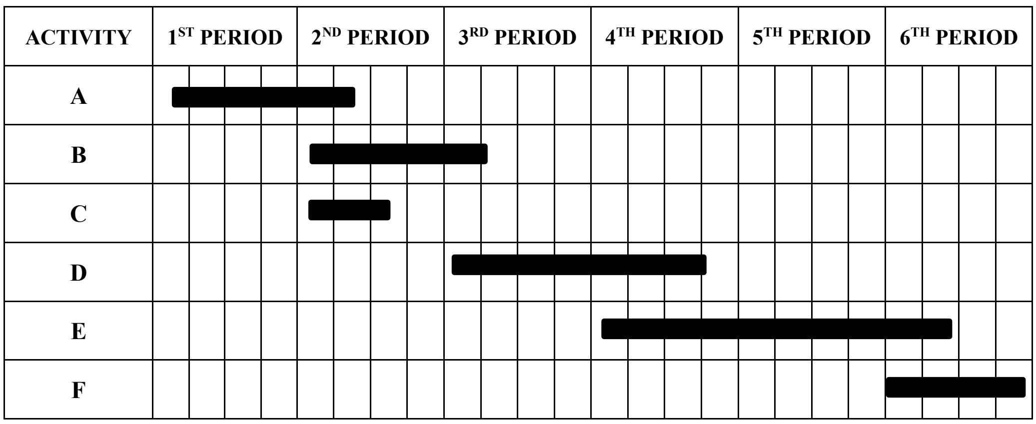
STRATEGIC PLAN	Strategic planning of the following 3-year period
DISTRIBUTION PLAN	Triennial operational and financial-economic planning of the sales network
COMMUNICATION PLAN	Annual operational and financial-economic planning of the main communication means
OPERATIONAL BUDGET	Economic-financial planning of the accounting period
SEASONAL PLAN	Planning of the procedures and programs of qualitative nature

Source: Our elaboration of: Terzani S., *Op. cit.*

The *strategic plan* which summarises the guidelines for the future three years of management based on a set of elements such as the internal and external environment, the market trends, the behaviour of the competitor and the consumer expectations.

The first fundamental step is the construction of the *collection plan*, it reflects the moment in which the two souls of the fashion companies find a meeting point: the creative soul of the designers and the rational one of the managers, with the aim of defining the articulation of the collection with respect to the product use functions, product types and price ranges. It is not just a simple projection of the previous periods results, but it is a tool for analysing and defining the management guidelines, also supporting the quantitative knowledge with the qualitative assessments deriving from the marketing area. Quantitative knowledge relates to information regarding sales of previous collections, on which an ABC analysis is carried out, on the other hand, the qualitative evaluations of the marketing area derive from the information coming from the agents, points of sale and customers. The preparation of these collection plans is useful, not only for the construction of the management budget, but also for the definition of the programs of the activities. Therefore, considering the internal and external workloads of all the resources, it is possible to evaluate the needs and programming the required effort over time. In fact, during the course of the activities it is possible to carry out a check of the progress of the collections through an examination of the actual work with respect to what was established. To set the sequence of activities in relation to the collection plan, a Gantt diagram can be used, it is a graphic representation where the lines correspond to the activities and the columns correspond to the days, weeks and months of the project duration. In this way, it is possible to check the progress of the project and of each phase of it by the length of the bar corresponding to the activity.

Figure 3.6 – Example of a Gantt diagram of activities



Source: Our elaboration

Another preliminary component of the budget is the *distribution plan* regarding long terms projects and fixed capital investments[68], which takes on different characteristics depending on the company's distribution choices. In the case of a direct sales channel, indications are provided regarding the opening of new sales points, and therefore choices pertaining to the type of store, their location, assessing the costs of the new initiatives. If instead an indirect channel is chosen, then the attention will be focused on the identification of new areas, new sales points, new distribution intermediaries.

The *communication plan* indicates all the choices and the relative costs that concern the communication policies that the company intends to adopt to promote the collections subject of analysed for the following year, for example advertising, promotion, events, etc. Such document allows to determine the monetary resources to be used for the communication, moreover, the most appropriate tools to promote the brand, the collection or the product.

The connection point between the distribution plan and the communication one with the operational budgets, is the *seasonal plan*. It is defined as a guidance of the activities based on their temporal frequency within each season. The managers of the control provide for the individual budget and the master budget, transposing in monetary and quantitative terms the choices made in the seasonal plan. For this reason, such plan is a link between the strategic planning, with a long-term vision of three years, and the operational programming which, instead, influences the logic of the seasons[69].

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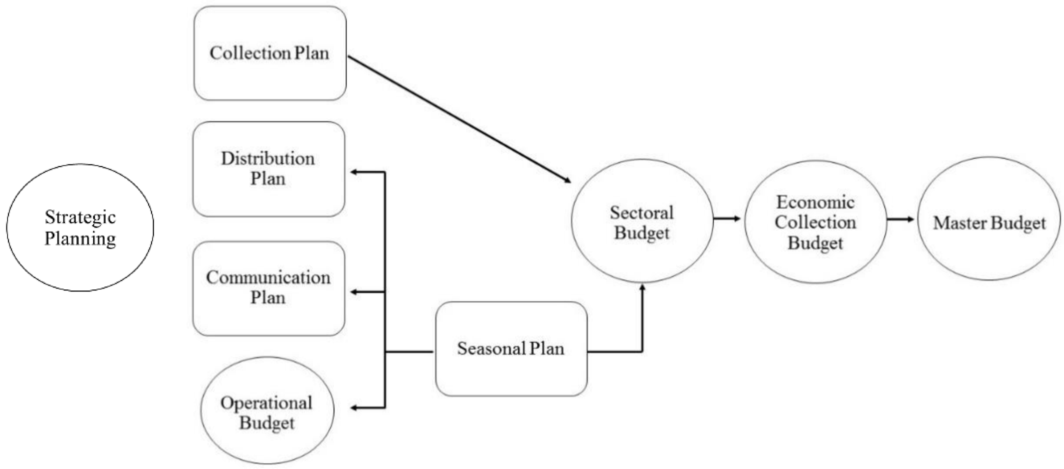
[68] Terzani S., *Op. cit.*

[69] Aglietti T., *"Processi e metodi della produzione per la moda. Sviluppo scalare dei modelli e tecnologie della modellistica industriale"*, Hoepli, Milano, 2003

Figure 3.7 – Elaboration process of the Preliminary Documents for the preparation of the Master Budget



Source: Our elaboration

The information gathered in the above described plans, converge within the managerial economic budget by collection and season, which are the result of the individual sectoral (functional) budgets articulated on an annual or interim basis and, subsequently, they flow into the company level budget.

The revenues that are budgeted in this management budget are extremely concise, obtained from the estimate of the number of garments per collection that are expected to be sold and the corresponding total value of the turnover determined considering the price policies that come out of the collection plans.

Concerning the variable production costs, they are the result of a rough assessment and, as the collection is not yet available, it will only be possible to estimate the percentage incidence of these costs on turnover. Subsequently evaluating the value of returns, discounts and commissions with respect to turnover, it is possible to make an initial estimate of the contribution margin with the aim of verifying whether and to what extent this margin is able to cover the specific costs of each collection and, therefore, if all these collection margins ensure coverage of the company's common fixed costs.

In order to carry out a more analytical analysis, it is necessary to examine for each item the positive and negative components (that can be variable and fixed) of the income, specific of each collection. In this case, the attention is focused on the costs that will have to be sustained by the style area for the realization of the collections and on the marketing costs for the promotion of the same. This analysis must be carried out accurately because the choices made will become operational within a limited period of time without having additional time during the programming phase.

Finally, the process ends with the estimate for each item and on annual basis of the common company components.

3.3.3. The timing of the budgetary system

Once the collection has been created, it will be appropriate to prepare the *Economic Collection Budget* before the sales campaign, around June for spring/summer and between October and November for autumn/winter.

"The collection budget represents the situation that the company expects in the future for what concerns the economic aspects of management, in other words

the trend of costs and revenues”[70]. The latter is a more detailed version than the first, which was based on the information contained in the preliminary plans, as there are available the bill of materials and work cycles.

The starting point consists in drawing up the *Sales Budget*, whose preparation can be more or less analytical if it is developed or not for a single article. A detailed elaboration of the sales budget for each product determines a complexity at organizational level, in fact very often it is preferred an easier and faster elaboration, through the identification of aggregates as for example based on the type of goods, customer, distribution channel or geographical area. Moreover, it is possible to determine a combination of the different dimensions, considering for example the customer with the type of product.

By using the data of the orders of the previous years, the number of items expected to be ordered for each type of product to determine the turnover are indicated, and moreover, including those that will supply the warehouse to establish a stock if there are higher orders or for the post-sales service management, such as restocking or replacement. As a result, the requirement in terms of quantity to be produced will be determined, it will then be necessary to draw up a *Provision Budget* indicating the product and its cost, the timing of supply and the different methodologies to manage the warehouse.

By making the difference between the requirements to be produced and the number of items to be purchased, we obtain the *Production Budget*, useful for determining the costs of raw materials and of the processing. The cost of the raw materials will then be calculated as a product of the quantities to be produced with the unit consumption per single component, while for the processing the cost is obtained by multiplying the quantity indicated in the budget by the estimated cost

[70] Saviolo S., Corbellini E., *Op. cit.*

of the various work phases. If external processes are used, the cost will be obtained by valuing the expected production times for the phases carried out internally.

Once the sales budget has been set with the provisional and production ones, the next step is to estimate the impact of budget adjustments, returns, discounts and commission costs, which can make changes with respect to the estimated weight in the formulation of the economic management budget, determining the contribution margin per collection and therefore per season.

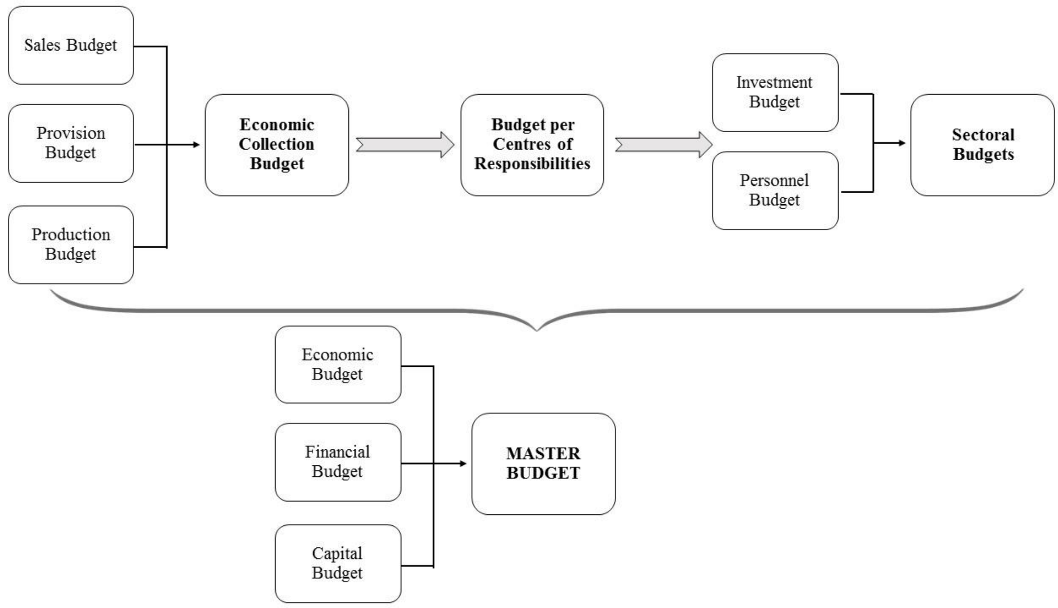
In conclusion, the economic management budget for the collection appears to be more significant and reliable, as it is the result of a more in-depth analysis and also because many of the activities have already been carried out, having the expenses incurred available, so it will constitute the basis for revenues and costs to be included in the Master Budget.

After having outlined the starting point for the preparation of the Master Budget, it follows the drawing up of the *Budget per Centres of Responsibilities*, such as the general management, R&D and administration. Moreover, the *Sectoral Budgets* are arranged with the support of other two documents: the Investment Budget and the Personnel Budget.

Finally, the high fashion company will coordinate the different dimensions included in each document, up to the elaboration of the *Master Budget* or *Budget at Company Level*, articulated in:

- *economic budget*, a statement of income concerning the following year;
- *financial budget*, it defines the programmed financial requirement and its sources of coverage (*sources/uses budget* and *cash-flow budget*);
- *capital budget*, which correspond to the balance sheet at the end of the year.

Figure 3.8 – Analytical Master Budget elaboration process



Source: Our elaboration

The difficult part in drafting this budget concerns the coexistence of working by seasons with the definition of the accounting period. The most obvious solution is to include the results of the two seasons within a single accounting period, determining for the sales of the two seasons the starting date of the accounting period before the start of the sales of the spring/summer collection, considering all the specific collection costs without taking into account the moment in which they were incurred.

Finally, the common components have no impact because they are not related to the seasons and are considered related to the financial year.

The optimal period for the preparation of the budget at the company level is therefore October so as to avoid the management queue of the autumn/winter season which, instead, could occur by drawing it up in November.

After determining the reference period for its preparation, the budget at the company level is simplified, since most of the information are already contained within the collection plan, so the revenues are known and must be divided between the different months in which they are expected to accrue. Furthermore, all specific variable and fixed costs must be associated with a monthly allocation.

For the common components of the period, it should be kept in mind that the available data are inserted into the system in advance with respect to their actual incurrence in February, and their subsequent distribution must take place on a monthly basis.

3.3.4. The cyclicity budgets

The most important peculiarity of the high fashion companies is the cyclicity of the company life. In this context, it is important to better examine two budgets expression of this feature.

The first one is the *Production Budget*, where there are dissimilarities between the total production budget of year "x" and the seasonal budgets of the same year, such as concerning the S/S budget of year "x" and A/W of year "x-1/x" they include only the production to be realized in the year "x", but at the same time, they involve also the part of production to be realized in year "x" but relative to year "x+1" for the S/S collection and "x/x+1" for the A/W collection. For this reason, there are problems in drawing up the production budget.

The second one is the *Financial Budget*, which includes the *Cash Flow Budget*. The financial one, determines the financial feasibility of the collections at annual level, and with respect to the cash flow budget, it does not highlight the possible requirements that could arise in specific periods of the year[71]. For this reason, it is necessary to monitor the cash flow of the management using the financial statement at the end of the period, and preventively the cash flow budget, which is the forecast on an annual basis, divided by months, of revenues and expenditures.

Generally, the production is carried out through the technological cycle that does not coincide with the monetary cycle related to the acquisition, to the payments of the productive factors and to the proceeds generated by the sale of the realized products. The payments of the resources used, in general take place after the beginning of production while the proceeds are made after delivery.

In the field of high fashion, the particular temporal articulation of the development process of the sample collection, the realization of the production and the sale of the collections, involve considerable delays also in the course of the same year, between moments in which outflows occur and moments where the related inflows occur. Therefore, such forecasts can grant a better indebtedness structure with a more conscious use of the financial sources, moreover, it defines times and methods of financing and resorting of a short-term loan[72].

From the analysis of the curves of financial flows by seasons, it is noticeable that in the collection development process the financial flows are negative for the expenses of the style area and the promotion of the collections, and also in the following order collection phases, materials procurement and the beginning of

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[71] *"It could happen that an annual management program is financially possible as a whole, but without highlighting huge liquid resources requirements in specific moments of the year, for example for seasonality sales reasons. Within the problem of liquidity, it is always crucial the time factor that need to be kept under control by using appropriate instruments"*

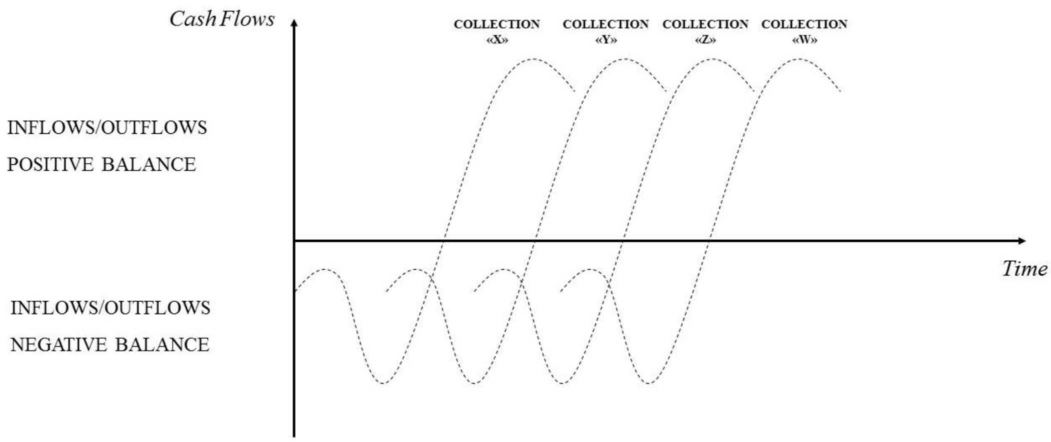
Brusa L., Dezzani F., *Op. cit.*

[72] Cavazzoni G., *"Il Sistema di controllo di gestione. Strumenti per le decisioni operative aziendali"*, Giappichelli, Torino, 2002

production activity. In fact, financial outflows are sustained which will affect much more negatively than the previous ones, implicating a greater inclination of the curves. Finally, with the sale of products, financial flows return to being positive, balancing the initial negative flows and determining a positive monetary balance of the season.

It is evident that in fashion companies, the negative flows anticipate the positive ones that are polarized in two specific periods of the year and, above all, at the moment in which the company bears the outflows linked to the development of a new collection, the revenues of the previous are just started.

Figure 3.9 – Net Cash Flows of each collection



Source: Our elaboration of: Terzani S., *Op. cit.*

This peculiarity entails the necessity of paying attention to the choice of the time horizon, starting from the collection revenues it is possible to estimate the revenues considering the incidence of VAT and the delays connected to customers, so as to verify when and to what extent will generate positive flows. The variable costs, on the other hand, must be calculated in relation to the timing of the fashion company.

In addition to this, further elements that increase the complexity of the

drawing up process of the treasury budget, derive from the international vocation of these companies, which makes the flow trend dependent on the exchange rate trend and on the hedging instruments that are used.

Finally, even the choice of the distribution channel influences the revenue trend, in fact, the direct channel immediately monetizes sales compared to the indirect sales one.

In the cash flow budget, it is appropriate to summarize, in addition to the movements relating to the operational management, also the financial effects of the operations of the investments area, new investments and disinvestments, the area of third-party financing sources, new financings and refund of financings, moreover the capital resources, capital increase and dividend payment. At the end of the process it is available the final monthly balance, to which will correspond the resources/initial requirement of the following month.

Following this temporal sequence, the company has the possibility to know in advance the monthly progress of the cash flow balances and to verify in which period it could determine situations of financial need. Subsequently, it will be possible to complete the preparation of the economic budget and, furthermore, the availability of financial movements and the economic result will allow the development of the capital budget.

3.3.5. Reporting System

A management control tool that works alongside the budgeting process to manage the huge amount of information produced and to carry out the analysis of the deviations is the *Reporting System*, which includes the processes of representation and communication of information to assess the effectiveness and the efficiency of the activities implemented and, therefore, to identify the critical aspects exposed to a more in-depth analysis.

Once the strategic plans and the operative ones are defined and elaborated, companies gathering and analysing final data throughout a set of documents.

The first one is the *Orders Monitoring*, that describes the advancement of the order acquisition during the sales campaign, useful in order to program the sales and to understand if the company will be able to be part of the planned sales budget. The presentation of the collection to the costumers, takes part during the catwalks or periodical meetings, in which the main clients define the number of pieces and models of the collection to purchase for the following season. Therefore, during these meetings, there is the definition of most of the budget for the next season.

Then, it is necessary to determine the trend of sales given by the *Sales Report*. This analysis takes place not only at the end of the accounting period, but also over the course of the year, allowing a refocusing on new objectives considered more achievable.

A useful document for this purpose is the *Forecast*, that is a new prediction at the end of the year of the budget measures, which constitutes a real profit and loss account based on purchased order data rather than on sales data. Its arrangement takes place twice a year, in the months of March-April and August-September.

Proceeding with the preparation of this preliminary profit and loss account by collection, for the recognition of revenues, purchase orders for the sales campaign are considered net of the value of any discounts applied. Regarding the variable cost of sales, they will be determined by analysing the consumption of raw materials and production considering the bill of materials and processing cycles, as in the collection budget determination. An estimate of the contribution margin per collection is obtained, which must be compared with the budget one. Finally, the determination of the specific costs borne up to that moment, which do not represent the totality of the specific collection costs, given that some activities have not yet been completed.

The whole company management trend is given by the *Actual Closing*, referred to economic-financial aspects.

In this profit and loss account, the revenues are given by the value of the turnover net of discounts and returns, while the cost of sales are determined considering the quantities of components transferred to the laboratories and valued at the weighted average cost and the actual cost of the work carried out. Moreover, all the final costs incurred with specific reference to the collection must be highlighted. In this case, only the net revenues and the cost of sales are taken into account in determining the contribution margin, however in the companies of the fashion system the exclusive use of this approach could constitute a limit, since the prerequisite for presenting an income statement at “cost of sales” concerns the fact that the final inventories can be sold at similar prices creating the same margins in the next period. Consequently, this statement is not truthful, because what is analysed are the seasons, not the periods. From this point of view, the only possibility for these companies to place their inventories is to resort to alternative sales channels, such as outlets or stockists, which free the warehouse even if they do not guarantee the same margins.

It is necessary to add another face of the income statement at “product cost”, which indicates the costs incurred to carry out the production regardless of the quantities sold. From these profit and loss accounts, two distinct contribution margins are obtained: one calculated as the difference between net revenues and cost of sales, the other is the difference between net revenues and product cost. Making the difference between the two margins, the cost of what has been produced but unsold is determined, which is a parameter for evaluating the collection and the season. The final result will be based on the ability to place this portion of production left unsold at acceptable values.

The companies in the fashion sector have a complex situation deriving from the fact that between the time of drawing up the budget and the time of presentation of the collection, the delivery and billing of the products to the customers, several months pass in which important activities are carried out, such as the order collection, provision of materials and production of items. In this perspective, it is required to prepare another report at the end of the orders’ collection from customers.

3.3.6. Deviation Analysis

At this point, once the preliminary and final budget data have been collected, it will be possible to carry out the *Deviation Analysis* which examines the differences between the standard values and the actual ones, relating to fixed and variable costs, prices and the production mix.

The first analysis is between the *budget values and the pre-final data* through the "Drill Down" logic, where from a synthetic data the analysis is deepened going down to lower levels following the hierarchical sequences. For example, in the fashion system it is possible to start by comparing the economic data of the final budget with the preliminary one concerning the season, and then making a breakdown based on the collection and compare the contribution margins based on the type of product.

The information needs that are satisfied through these analyses are various, in fact the differences between the expected revenues and the value of the order, indicate the actual appreciation of the collection by customers, while the differences concerning the variable cost represent the company's ability to obtain more favourable conditions at the moment of the acquisition of the raw materials or of defining the processing programs at the laboratories. The analysis of the deviations must not be based only on the comparison between the data but it must investigate the specific causes of the dissimilarities, starting from the analysis of the contribution margin at the product type level, verifying that such differences are attributable to two main causes: a change in volumes or a change in the contribution margin.

The first one is *the change in the contribution margin* that concerns a deviation of its components, variable revenues and costs, which determine a price, efficiency and cost variance. In addition, there are also deviations relating to production factors, leading to changes in the prices/purchase cost of production factors and, in addition, differences due to the efficiency of their use.

The change in volumes is based on the definition of an average contribution margin, given by the weighted average of the contribution margins, analysing the percentage incidence of the budget turnover of each product with respect to the overall turnover. The volume variance is given by the variance in quantity and sales mix, so if, with the same contribution margin for each product, a shift in sales towards those products with a higher margin is measured, there will be an overall increase in the company margin. In the other hand, if the object of analysis is the collection or the season, it will be necessary to add the deviation of the specific fixed costs. With regard to sales volumes, in order to make the negative and positive components of income to emerge more incisively, *Flexible Budget* are used, that is a budget statements equal to the others in their structural parts, but which adapt to changes in sales volume neutralizing them. *"A flexible budget provides estimates of what costs should be for any level of activity within a specific range. When flexible budget is used in performance evaluation, actual costs are compared to what the costs should have been for the actual level of activity during the period rather than to the budgeted costs from the original budget"*[73].

At the end of the operating cycle, it is possible to have the final data available, therefore it is possible to implement a further comparison between *the budget and the final budget* and the *pre-final budget and the final budget*.

Considering the final balance, it is possible that there will be differences regarding the causes of the deviation, or in the causes of the lacked withdrawal of the products and of returns.

At company level, analysing the final results has different characteristics depending on the financial or economic dimension. The financial dimension requires monthly monitoring, where at the end of the period the cash-flow budget data must be replaced by the actual ones, while for the following months a revision of the initial forecasts will be made, which are not based on the economic values of the budget, but on the analysis of orders and invoices. With regards to the economic dimension, the control of the results at the company level is the same as that predicted for each collection or organizing a collection of final data system that allows to generate synthetic and monthly profit and loss accounts and develop variance analysis of revenues and costs elements.

[73] Garrison R. H., Noreen E. W., *"Managerial accounting"*, McGraw-Hill, New York, Milano, 2003

The analysis of the deviations is the prerequisite for the elaboration of the *final projections*, that is a forecast carried out quarterly, regarding the probable future trend of the collections. At the collection and season level, when the products are delivered, it will be necessary to develop forecasts obtained from the projection of final data, useful for verifying at company level how the operating result is being determined.

By linking the pre-final data with the projections, it is possible to plan the purchases and the production. In fact, knowing that the materials provision process and the production process begin before the sales campaign has been completed, it is important to develop a process that, starting from the analysis of the pre-final data of orders, foresees a final projection of sales. To the data obtained from the projection, will be added the quantities of products for the warehouse, determining the production requirement. Subsequently, subtracting the portion of products to be purchased, the production program is obtained, which lays the foundation for determining the material and processing requirements.

3.4. The Balanced Scorecard Model

The Balanced Scorecard is a performance evaluation model proposed in the early Eighties and subsequently deepened by Robert Kaplan and David Norton in 1992[74]. The two authors presented the results of their research, stating that the economic-financial variables were not enough in order to explain the company performance and that it was necessary to identify other indicators with different nature, that would enable a multidimensional measurement of the results of the company.

"The BSC is an integrated system of synthetic measures of the company performance based on the strategy, competitive necessities and distinctive expertise"[75].

From this definition, it deduces some characteristics which mark this tool. The first one is that it is a *synthetic system of measures* of the company performance. The BSC is an "Executive dashboard" of measures, a set of indicators with the same goal of representing in a synthetic manner the company performance. Throughout this tool, they are identified, thanks to few essential "drivers", the achieved results of the company management and, furthermore, they support them with the strategic and operative choices.

Moving on, Kaplan and Norton consider another fundamental feature that defines the BSC as an *integrated system of measures*, in fact, the indicators should have a huge level of integration. The measures placed inside the "Executive dashboard", are articulated in four different analysis but closely integrated, in order

[74] Kaplan R. S., Norton D. P., "*The Balanced Scorecard: Measures that drive performance"*, Harvard Business Review, n.1, Boston, 1992

[75] Gatti M., *"Balanced Scorecard and Cost Management: riferimenti teorici e casi aziendali"*, Esculapio, Bologna, 2011

to understand the relation cause-effect between the indicators and the various analysis perspectives from which derive the results at each business unit level.

The last but not the least, is that the BSC is based on *company strategies, competitive necessities and distinctive expertise*, that are the starting point for the creation of a great "Executive dashboard". Moreover, the strength of the BSC is the set of indicators composed by both internal and external variables.

Control must focus on four elements, defined as improvement perspectives:

- the economic-financial perspective, to assess the company's performance;
- the customer perspective, to assess the extent to which the customer's needs have been met;
- the perspective of internal processes, to examine the level of performance of the processes developed within the organization;
- the perspective of learning and growth, to assess the extent of intangible resources to improve them and acquire specific competitive advantages.

Regarding the fashion sector, characterized by a poor standardization and an extreme research for quality in the product and in the service offered, those who manage to position themselves adequately within the market, suffer lower pressures on margins than other sectors. For this reason, it is absolutely necessary to focus attention on the performance of the *point of sales* (POS), rather than on production and organizational efficiency.

Following the viewpoint of the four perspectives, the most important to carefully monitor is that of the clientele, with a meticulous analysis of the sales and performance of the individual point of sales and of the various distribution channels, with an appropriate market research carried out to come to know the profile of consumers and understand their needs.

In the construction of the Balanced Scorecard model, a first critical point on which to focus attention is the choice of the most appropriate organizational unit from which to start. In fact, this tool is so articulated that do not allow the construction of a single business unit for the entire company, but it is appropriate starting from the lowest hierarchical levels, such as the strategic business units, and then gather them into one relative to the company as a whole.

In the companies of the fashion sector it is advisable to implement this model starting from a single type of product, for example clothing, footwear or accessories, up to the integration at company level.

Once the starting level has been identified, proceeding with the stages of the model implementation, both the contact persons of the individual strategic business units and all those who are actively engaged in the daily management of the company will be involved in the process, also with the participation of the highest levels of the organization.

After having prepared these measures and the objectives to be achieved by each area manager, those considered essential are organized in order of importance, carrying out for each one an analytical description and specifying the methods to achieve them.

At this stage, it is necessary to take into consideration:

- the fundamental objectives set for each area and the measures able to trace the tendency of the relative performances;
- the sources from which to find all the useful information to calculate the different performance indicators identified;
- the interrelations between the various performance measures and the ways in which each influences the other.

Concluding this process, a document will be produced in which the results achieved and the contact persons that is responsible for each perspective are summarized. Subsequently, this document must be broadcasted within the organization in such a way that everyone understands how and in what terms the consensus for the project was obtained. In essence, the objectives will be achieved only if there is a connection between strategy and action and, for this reason, the budget is used which create a relationship between the short and long-term objectives linking the strategy to the operational dimension.

However, the introduction of a Balanced Scorecard model entails considerable efforts within companies, as it is necessary that adequate indicators are chosen and combined to represent the four dimensions of the structure. Therefore, it is necessary to combine non-financial indicators that look to the future, with financial ones that look to the past[76].

Particularly important, is the evaluation of the trade-offs that can occur between the various indicators and their possible changes over time.

The purposes that the company can achieve with this tool are ascertainable both when the strategy is formulated and when it is translated into action. Moreover, it is useful at the time of planning, because it allows to measure the results and specify the timing for achieving them and, then, spread them at all organizational levels.

This model is more effective and timelier in determining the causes of the results obtained, also identifying the interventions to be implemented to improve future performance, compared to traditional control instruments.

3.4.1. The Balanced Scorecard's four perspectives

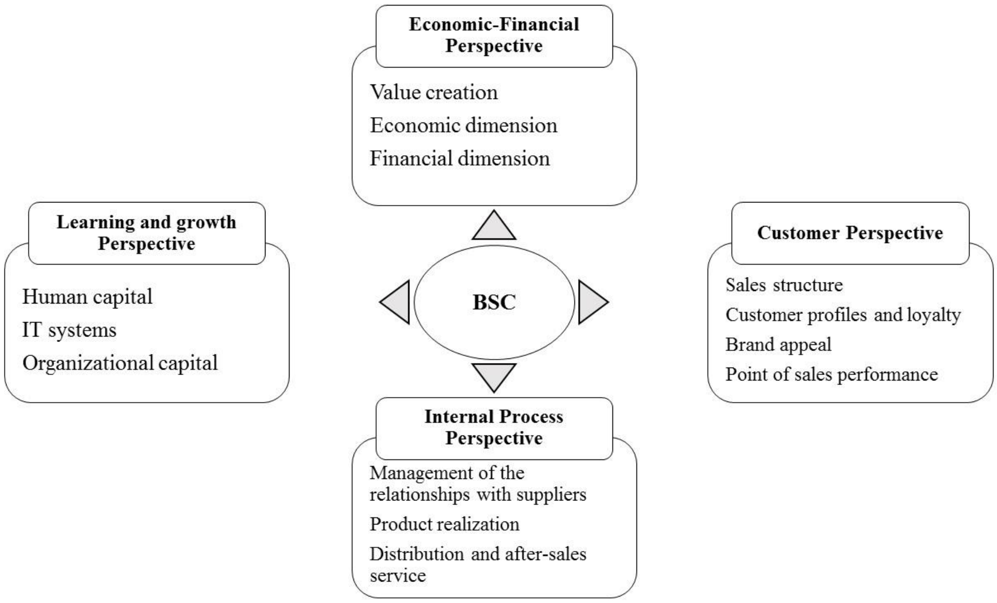
By observing the four perspectives, it is possible to understand how the BSC differs from the traditional performance measurement tools. The latter, in fact, takes

[76] Meyer M. W., *"Al di là della Balanced Scorecard",* Etas, Milano, 2004

into consideration only one dimension, that is the economic-financial one, as matter of fact, the budget and reporting systems consider only the monetary dimension.

However, in modern markets, the company performance is given by the achievement of various goals such as the customer satisfaction or the innovation ability, that can't be monitored with the traditional economic-financial measures.

Figure 4.0 – The Balanced Scorecard's Perspectives



Source: Our elaboration of: Terzani S., *Op. cit.*

For this reason, there is a need for a more articulated picture of the different dimensions that make up the global performance, identifying new measures able to focus attention on future performance and, moreover, to support decision-making processes in the long term.

The economic-financial indicators are accompanied by other physical-technical ones, which evaluate the efficiency and effectiveness of the management processes, supporting the monitoring of management phenomena that, otherwise, would not have been considered such as the style area, the marketing area, provision processes, production processes and the logistics and distribution area[77].

Among all these physical-technical indicators, in order to choose the key ones for the corporate evaluations of each company, it will be necessary to identify which are the critical success factors of the company compared to its competitors. Subsequently, it will be appropriate to link them to critical strategic variables, on which the satisfaction of critical success factors depends. Finally, the processes that directly impact the critical variables will be identified, in order to define the *Key Performance Indicators*.

In the fashion sector it is not possible to list a set of general indicators for each entity, but it is still feasible to make observations in relation to the adopted business model. For example, basing on the distribution channel, the companies that focus their success on retail will be more inclined to use indicators related to the points of sale, such as the turnover per employee or the average number of pieces and the average amount of the receipt.

The economic-financial and physical-technical indicators will be considered jointly within the perspectives analysed in the Balanced Scorecard, to assess how the management control is carried out, focus attention on the measures useful to evaluate the observation areas considered critical for the achievement of the business success.

[77] Terzani S., *"Problematiche gestionali e di controllo nelle imprese dell'alta moda"*, In: "I quaderni del dottorato", n. 12, Il Prato, 2006

The economic-financial perspective

The economic-financial perspective focuses the attention of the company's performance from the point of view of the shareholders and the financiers. This is possible through the use of economic-financial indicators, which represent the most immediate quantitative translation of the strategic objectives set by the company and, moreover, they collect the fruit of the efficiencies and inefficiencies present within the various functional areas. The main purpose of this dimension is, in fact, to assess the performance of the company in terms of estimation of the value created for the shareholders, regardless of the phase of the life cycle of the products.

The economic and financial measures used are useful as a good financial control system, it is also an incentive to develop adequate "total quality" programs especially since it is not taken for granted that an increase in efficiency and operating efficiency automatically corresponds to an improvement in financial performance. These measures, however, are not sufficient to explain the success or failure of the company, for this reason it will be necessary to bring together the monetary dimension, the quantitative and qualitative ones of operational nature.

However, the major problem lies in interpreting the economic-financial variations through the performances obtained in the other dimensions and, thus, identifying the contribution of each area to the overall realization of the value for the shareholders. For this reason, there are three performance categories that it is considered appropriate and important to monitor within fashion companies: value creation, the economic dimension and the financial dimension[78].

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[78] Fazzini M., Terzani S., "*Una proposta di Balanced Scorecard nelle imprese del sistema moda*", in: "Controllo di gestione", n. 1, Ipsoa, Milano, 2008

Figure 4.1 – Performance measures of the Economic-Financial Perspective

INFORMATION CATEGORY	MEASURES
Value Creation	EVA®
Economic Dimension	ROI - ROS - CT Sales Sales per operator Sales per square meters of the POS Cross-selling rate Costs Collection costs Advertising costs POS costs
Financial Dimension	Net Asset Inventory Inventory turnover Inventory per square meter of the POS Working capital Cash-flow Debt Structure

Source: Our elaboration of: Terzani S., *Op. cit.*

In *value creation*, the most representative indicator is "EVA®"[79], which measures the value of the company from the difference between adjusted operating income after tax and the cost of capital employed multiplied by the invested one.

[79] "*Economic Value Added*", measures the creation of value within the company, given by the difference between adjusted operating income net of taxes, and the cost of capital employed multiplied by the capital invested:

$$EVA = NOPAT - (WACC * CI)$$

Where:

NOPAT is the "Net Operating Profit After Taxes"

WACC is the "Weighted Average Cost of Capital"

CI is the "Capital Invested" (Equity Capital + Financial Payables ± Adjustments)

Considering the fashion sector and its functioning by seasons, this indicator must be calculated every three months and, therefore, for each collection.

Moving on with the *economic dimension*, the most widely used indicator is the ROI[80] "Return on Investment", which its development formula[81] focuses not only on investments but also on sales profitability and capital turnover, measuring the level of corporate efficiency and, moreover, it allows to understand the company's positioning on the market.

Generally, in fashion companies there is a high level of ROS "Return on Sales" and a moderate turnover of capital. Furthermore, it is a key indicator in the sales analysis, considering also revenues and costs: the former is analysed taking into account sales per operator and sales per POS. Regarding this area, the *cross-selling rate*[82] has a great importance, which shows how much the brand can attract customers with different products compared to the typical ones.

In calculating the costs there is a difficulty concerning the need of isolating those of the collection samples and of the model development, from those of production. Furthermore, there is the necessity to renew the collections from year to year and this entails considerable difficulties in monitoring them, in fact, by meeting these needs and difficulties, it is appropriate for fashion companies to conduct an in-depth examination on particular cost categories (related to the collection), advertising and point of sales.

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[80] ROI = "Return on Investment", given by the Operating Result (EBIT)/Net Capital Employed (NCE)

[81] The developed formula of the ROI is: ROI = ROS x CT

Where:

ROS or "Return on Sales", is given by the Operating Result/Sales Revenue

CT or "Capital Turnover", is given by the Revenue from Sales/Invested Capital

[82] "Cross-selling rate", given by the Sales Revenue of Accessories/Sales Revenues of Key Products

Finally, the *financial dimension* must be carefully analysed, taking into consideration the fact that the seasonality of the management of companies in the fashion sector means that costs and revenues are concentrated mainly in specific periods of the year. This determines the need to correctly manage cash inflows and outflows in order to have lower interest rates thanks to lower bank exposure in periods characterized by greater financial outflows. In addition to the analysis of corporate cash flow and the structure of debt, attention must also be focused on company assets and working capital.

The customer perspective

In the fashion sector, customers play an important role, in fact internal processes and R&D are efficient only if the final product is appreciated. Fashion is a social phenomenon and therefore companies must understand the needs of the market in terms of tastes and trends, trying to develop new ones.

The purpose of a correct business management is creating value for the end customer, in order to have a customer-oriented perspective. For this reason, an Activity Based Profitability Analysis model has been created, with the aim of estimating the costs and revenues of each individual activity from the end consumer perspective. To achieve this goal, companies adopt a two-stage model: first of all, the market must be segmented distinguishing the core-business and the accessories, subsequently the companies will have to identify drivers to evaluate the amount of value observed by the customer.

The sales structure is measured starting from the segmentation of the market, so as to be able to identify the sales performance divided by brand, collection, product and geographical area. An in-depth analysis of the market highlights the various segments in which it is composed and the preferences of customers referring to critical success factors, such as quality, price, image and reputation. If the customer segment is not considered sufficiently profitable, the sales performance will also be unsuccessful, so there is the need to combine a preventive economic-financial analysis to evaluate the profitability of the segment, avoiding too much focus on the customers.

To analyse *the profile of the clientele and its degree of loyalty*, the companies must identify the main characteristics of the final consumers, their needs and their desires in order to satisfy them in the best possible way. To accomplish this task, it is necessary to carry out a market investigation or using the information gathered in the point of sales. According to the customer's profile, the interesting measures to focus on are the average amount of the receipt and the number and type of average pieces sold per customer, which will be used to assess the customer's purchasing power and the cross-selling rate. Moreover, it is essential to analyse the relationship between the number of issued receipts and the number of customers who entering the store, to understand if there are new profitable market segments.

To assess the degree of loyalty it is useful to observe the relationship between orders received from regular customers and the total orders placed, as the market share is based on keeping the existing customers. Considering new customers, it is necessary to evaluate the number of new buyers or the total sales to new customers, keeping the overall costs incurred for the new customer's purchase under control. The fashion companies, from this point of view, try to increase the degree of brand membership in the final consumer, useful for evaluating the fidelity rate, that is the percentage of buyers returning to the same point of sale during a certain period of time.

The brand appeal is another important information for assessing the success of the company, it is the intangible key for fashion companies. In fact, the brand has a symbolic value, so that the customer perceives less the risk associated with the purchase of a product. The use of these indicators relating to the brand are relevant, as well as to evaluate the failure or success of a fashion company, also to understand if the degree of appeal of the brand generates attraction of new customers on different products compared to those traditionally sold. The models of measurement of the brand equity can be grouped together in two categories: qualitative, evaluating the brand and the consumer behaviour and quantitative, aimed at obtaining a monetary evaluation of the brand.

Finally, the widespread use by fashion companies of the direct sales channel, gives detailed information on *the performance of the POS*. One of the most important indicators to be calculated is the "seasonal sell-through". It is the ratio between the quantities sold of a product and the quantities ordered by the single point of sale, which makes it possible to verify the popularity of the collections. Furthermore, it will be necessary to evaluate the direct impact of the seasonal sales on the margins of the business and verify the presence of an accurate management of the stock levels[83].

[83] Sacerdote E., "*La strategia retail nella moda e nel lusso*", Franco Angeli, Milano, 2006

Figure 4.2 – Performance measures of the Customer Perspective

INFORMATION CATEGORY	MEASURES
Sales Structure	Revenues and contribution margin per brand Revenues and contribution margin per collection Revenues and contribution margin per product Revenues and contribution margin per geographical area Customer portfolio
Client Profile and Loyalty	Percentage of orders from regular customers Percentage of sales from new customers Number of pieces per sales receipt Number of fidelity cards and registered customers Number of invitations to fashion shows
Brand appeal	Market shares and positioning Cross-selling rate External market researches
POS Performance	Seasonal sell-through Conversion rate Size of the liquidation sales rate Impact of the promotional codes on the total amount of key codes Impact of the total promotional sales on the total sales

Source: Our elaboration of: Fazzini M., Terzani S., *Op. cit.*

The internal process perspective

Concerning the perspective of the internal processes, it is necessary to take into account the evolution in the cost calculation and, therefore, the relevance of the Activity Based Costing method. In fact, the logic of the company is based mainly on activities and processes, rather than on the functional logic of the centres of responsibility. Moreover, the growing interest in customers has led to the need of analysing and evaluating the upstream processes of the finished product, in order to determine those with greater added value for the final consumer and eliminate the inefficient ones.

In fashion companies there is a difficulty regarding the identification of the boundaries between the internal and the external dimension, in fact, for example, the collection is the output of a process given by the continuous exchange of ideas between inside and outside external. For this reason, the process perspective is developed, taking into consideration the value chain composed of three main phases: the management of relationships with suppliers, the product realization, the distribution and the after-sales assistance.

Figure 4.3 – Performance measures of the Internal Process Perspective

INFORMATION CATEGORY	MEASURES
Management of the relationships with suppliers	Suppliers rating Processing time of the orders Order fulfilment on time Percentage of manufacturing defects Number of innovations proposed
Product realization	Cost per unit of output Manufacturing defect rate Quality costs Production timing Impact of the outsourcing
Distribution and after-sales assistance	Delivery costs Processing time of the orders Percentage of fulfilled orders on time Percentage of claims Quality of after-sales services

Source: Our elaboration of: Fazzini M., Terzani S., *Op. cit.*

In the analysed sector, *the management of the relationships with suppliers* has a crucial role for the high quality that companies must guarantee, and the high flexibility required within the production system. Suppliers will not only have to restock companies but become real production partners. In fact, having a good relationship with them guarantees companies to reduce time and costs, moreover, this allows them to have an advantage over their competitors. It should be kept in mind that a fashion company generates two or three different productions for each year, considering the seasons and the men's and women's sectors, so there is a short period of time between the approval of the collection and its distribution. For this reason, the partnership with the suppliers is very important in order to respect the times and the quality standards.

Very often high fashion companies, for *the realization of the product*, prefer to outsource the production process to the outside, for reasons of competence, cost reduction and flexibility.

Finally, the *distribution and after-sales assistance* phases include the placing of products on the market, together with warranty and repair activities, returns management and proceed methods. Given the customer orientation, it is necessary to pay particular attention to the after-sale services to satisfy the customer's needs and, moreover, it will help not only to maintain the regular customers but also it will increase them. To measure the degree of functionality and efficiency of this process, the following are evaluated: the distribution activity through the delivery costs, order processing time and the incidence of orders dispatched in compliance with the set deadlines. Furthermore, considering the assistance and support that the company is able to provide to customers after the sale, the percentages of complaints received, and the quality of after-sales services will be measured.

The learning and growth perspective

The growing attention to the perspective of learning and growth responds to the need of creating products that can guarantee business success, contrary to what happened in the past where the attention of entrepreneurs was strongly focused on productivity. This change is caused by a progressive shift of attention towards customers, which, given the same product and price, begins to prefer those companies that are able to guarantee higher quality standards and greater after-sales assistance services. Furthermore, considering that, today, achieving production efficiency is no longer an impossible goal, it is more difficult to overpower the competition from this point of view. In fact, production efficiency is a necessary element for any company to remain on the market and run parallel with customer satisfaction. For these reasons, research and development and learning activities are of crucial importance, as competition is based on anticipation of timing, the presentation of products/services that are always new or superior in quality compared to competitors; and no longer on the ability of placing on the market a product at a lower price or by offering a better after-sales service.

Figure 4.4 – Performance measures of the Learning and Growth Perspective

INFORMATION CATEGORY	MEASURES
Human Capital	Strategic positions turnover Income per designer Added value per designer Retraining costs of the employees Number of new collections Average age of the designers
Information Systems	Efficiency of information processes Strategic coverage ratio of the information Percentage of divisions involved in the information system
Organizational Capital	Number of suggestions per employee Percentage of employed people in inter-disciplinary tasks

Source: Our elaboration of: Fazzini M., Terzani S., *Op. cit.*

The three categories of information that must be taken into consideration in the context of learning and growth are: human capital, information capital and organizational capital.

Starting from ***human capital***, it is very important to underline the fact that managers who follow a rational logic, and stylists who are more oriented to follow inspiration, live together in the fashion system. Consequently, it is necessary to ensure an effective and efficient connection between these two categories. The human capital, that is the source of the competitive advantage of companies, is subject to a specific turnover since designers and production managers lose their innovative drive after a certain number of years and, therefore, it is advisable to look for new ones that stimulate production[84]. Moreover, it is necessary to evaluate individual productivity considering, in addition, the revenue per employee and the added value per stylist. Another aspect to be evaluated in terms of human capital is the retraining costs of personnel, as it is essential that the company always has a number of highly qualified people capable of covering key roles of strategic importance.

The *information systems* category is another important dimension to be evaluated, given that fashion companies are structured in various branches, with the possibility of locating the commercial offices, the production and distribution processes in different geographical areas. It is of primary importance to develop information technology systems capable of effectively communicating and, to give the opportunity to share the knowledge and experience gained by the various departments, avoiding misunderstandings and inefficiencies.

Finally, there is the *organizational capital*, which deals with the motivation of the staff, the improvement of the team work skills and the development of the corporate culture, in order to understand the company's mission, identifying in it and to understand what actions will be implemented to give substance to the strategy. For designers, the translation of the company's objective, throughout the design of products, leads them not only to be involved in the company process, but also to study the trends of the external environment allowing them to have an exchange of inspirations useful for achieving the final objective.

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[84] Brusa L., "*Attuare e controllare la strategia aziendale: mappa strategica e Balanced Scorecard*", Giuffrè, Milano, 2007

3.4.2. Balanced Scorecard development

One of the fundamental elements to be taken into consideration for the effective implementation of a Balanced Scorecard model is the involvement of senior executives and senior management and, especially, to have the sponsorship and participation of the highest levels of the company organization.

The first problem concerns the consensus of top management, their sponsorship and, above all, the comprehension of the reasons for which it is decided to proceed with the construction of a Balanced Scorecard system.

There is no doubt that another problem to deal with concerns the choice of the most appropriate organizational unit from which to build this evaluation report. There may be cases in which the organizational structure is so articulated that it is difficult to construct a Balanced Scorecard directly for the whole structure and, instead, it may be more appropriate to start from the lower hierarchical levels, such as the strategic business units (SBUs). Furthermore, it would be advisable to start with *"activities that cover the entire span of the value chain: innovation, operations, marketing, sales and services"*[85].

However, in the formulation of the objectives and in the evaluation of their realization, it must be considered that not all the levers are completely manoeuvrable by the SBU and that they also depend on the behaviour of the other business units. It is, therefore, necessary to determine the relations among the SBUs and between the SBUs and the head office.

Once the level from which to build the sheet is identified, it is necessary to define the steps for a correct creation of the system. A fundamental element is the construction of an adequate consensus relative to the project, for this reason it is

[85] Kaplan R. S., Norton D. P., *"Balanced Scorecard: translating strategy into action"*, Harvard Business School Press, Boston, 1996

advisable for the manager to involve the representatives of the various areas and of the individual SBUs. The managers of the various groups and the "architect" of the whole structure will vote to determine the objectives considered fundamental and, an articulated description of the objective and the methods through which it is intended to reach them will be elaborated.

At the end of the meeting, the "architect" will draw up a final document summarizing the results achieved, listing the executives who have been appointed responsible for each prospect. Subsequently, this document must be disseminated within the organization, so that everyone can understand the program to be implemented, trying to obtain the consent of all the actors involved.

A fundamental aspect for the effective implementation of the strategy is the interconnection between strategy and action[86].

In this sense, a key role can be played by the budget that must link short-term and long-term goals. There was, therefore, the introduction of the *"Rolling Forecast"* models, which allow an adjustment of the budget to the actual performance of the company. *"A Rolling Forecast is a type of financial model that predicts the future performance of a business over a continuous period, based on historical data. Unlike static budgets that forecast the future for a fixed time frame, e.g., January to December, a rolling forecast is regularly updated throughout the year to reflect any changes as time goes on. That is, it relies on an add/drop approach to forecasting that drops a month/period as it passes and adds a new*

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[86] "*There are five keys to success in order that a strategy and, therefore, a change at organizational and strategic level are successful; these are: 1) explicit and conscious involvement of people; 2) use of intensive information to create a receptive environment to the change; 3) adoption of an incentive system consistent with the changes introduced; 4) introduction of changes such as to give the opportunity to all workers to deal with decisions aimed at creating value"*

Varicelli A., *"Dalla strategia all'azione: il collegamento passa per la BSC"*, in: "Amministrazione e Finanza", n. 12, Ipsoa, 2005 *month/period automatically. This enables companies to project future performance based on the most recent numbers and time frame, which offers an advantage when operating in a fluid and ever-changing business environment"*[87].

There are two elements that must be taken into consideration for the correct implementation of a Balanced Scorecard model. The first concerns the link between strategy and operational dimension and, in this regard, it is important to create a strategic map for a more correct identification and clarification of the company objectives. In fact, it is not possible to manage what you cannot measure, and at the same time, you cannot measure what you cannot describe.

"Theoretically, the strategic map and the set of initiatives taken to support the objectives are useful in order to fully describe the strategy, while the set of indicators monitors their execution"[88].

Furthermore, the Balanced Scorecard model aims to verify the correct execution of the strategy but also to assess the validity of the strategic hypotheses. Therefore, it is necessary to have identified and described the strategic objectives, to determine the most suitable indicators for monitoring their execution.

A second element that must be taken into consideration is related to the organizational aspect, in fact, a correct implementation of the model cannot exclude a deep analysis of the organizational structure of the company. The adoption of the model has the intrinsic purpose of rethinking the organization and the behaviours held within a company.

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[87] Corporate Finance Institute® (CFI), Financial Modeling and Valuation Analyst® (FMVA), *"Rolling Forecast: A financial model that moves forward one month at a time"*, Published on: CFI™, https://corporatefinanceinstitute.com/resources/knowledge/accounting/rolling-forecast/

[88] Baraldi S., Bocci F., Bubbio A., *"Balanced Scorecard: ambiti e modalità di applicazione"*, in: "Controllo di gestione", n.6, 2004

CONCLUSIONS

The fashion system is a complex organism of activity, conditioned by the succession of the seasons and, consequently, by the interweaving of the collections that influence the timing of business management, making it more frenetic and dynamic than the working cycles of traditional sectors. Another fundamental characteristic of this sector lies in the typology of products offered, for which a careful identification of the customer target is required and, moreover, to which all the services necessary for their satisfaction must be provided, with the ultimate aim of obtaining loyalty and useful information to implement increasingly punctual management choices. In fact, to achieve the company mission, companies cannot rely on a casual combination of resources, but must specify how to use and integrate the resources available in an effective and efficient way, to achieve corporate objectives not only in terms of turnover but also in terms of customer satisfaction. For these reasons, management control is introduced in the planning and programming process, which enables the economic balance to be translated into specific decisions and actions, which have as their final goal the achievement of short-term planning objectives, which are, in turn, the translation of the long-term ones of the strategic planning.

The traditional tools of management accounting, such as the budget and analytical accounting, must be adapted to the reality of the fashion industry. The first is subdivided into budgets per collection, distribution and communication and subsequently drawn up at the collection/season level, before the final drafting at company level. Its objective is to coordinate the various activities, to control, motivate and increase the individual learning of the staff, as well as to the traditional quantitative monetary informative function concerning the business management trend. As far as analytical accounting is concerned, there are difficulties in determining the cost objects to which to assign the overall share of costs incurred by the company. In fact, in the fashion sector, the definition of costs changes according to the extension of the cost object to which they refer, having also some typical costs such as those of collection, communication and variety.

Regarding the allocation of costs, traditional methods such as the Full Costing and the Direct Costing are replaced by a logic based on activity, with the implementation of an Activity Based Costing, specifically the Activity Based Traceable Costing which analyses fixed costs by subdividing them into specific and common ones, attributing the latter to the related activities. With the adoption of the Activity Based Costing, there is the utilization of innovative control tools based on management per processes and, moreover, it moves from a logic of results to one based on the management of the causes of the results. In fact, in the fashion system, the volumetric distribution criteria of traditional cost allocation systems lose their validity because they implicate an increase of the indirect costs as a result of a higher customer orientation and the variety of the offer proposed on the market. This methodology focuses no longer on the final effect, but on the monitoring of the activities, in order to promptly undertake those corrective actions that allow the achievement of the set objective.

The companies of the Italian fashion system are partly reluctant to implement these new tools, as very often they have a family-run organization with a trend of substantial and constant profits and, they are not inclined to pay particular attention to the management control process. The situation changes if the company has a large structure and, especially in periods of growth and diversification which involve an internal reorganization and a necessity of focusing on the critical success factors.

Companies in the fashion industry will have to concentrate on achieving a final result in terms of profit and above all, on customer satisfaction, on the maximization of the processes developed internally and the growth of intangible resources. To this end, the Balanced Scorecard aims to analyse the correct execution of the management control by paying attention to the critical success factors. The latter, in turn, are monitored by the economic-financial and physical-technical indicators, which focus attention on the measures to be taken in order to determine the critical observation areas.

In conclusion, management control is of fundamental importance for every typology of company that aims “to keep up with the times" and to maintain or increase its own competitiveness towards the competitors. Moreover, this is extremely relevant for achieving business success and short and long-term goals, also determining possible future business trends. These tools make it possible to excel in the market as a real element of competitive advantage, perfectly fitting companies in the fashion sector, a stronghold of the Italian entrepreneurial system that has always been famous and respected worldwide which deserves to be preserved.

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