



**Collinson**

**Grant**



**Confidential**

**Financial colleges in companies**

**A short introduction**

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## 1 Introduction

A financial college is a device available to any business in which the finance function operates at several levels in a well devolved structure.

That structure, though vital, is not the point of a financial college. It is the protocols that shape the relationships between the finance officers at different levels, and between them and the general managers to whom they report, that matter.

The purpose of a financial college is to put into effect, at every level in an organisation, unusually strong and coordinated practices of financial control. Given powerful cultural and philosophical support, this approach acts as a check on the unilateral power of managing directors or their equivalents in subsidiary organisations. So, it strengthens corporate compliance and produces more rational decisions and a better balanced process for taking them.

## 2 The purpose of a financial function

A financial college model rests on the assumption that decisions in most aspects of business operations nearly all have some financial significance, ranging from high to crucial. All decisions of sufficient moment ought to be supported by a view from the appropriate finance manager.

It is up to the Finance function to make those financial implications clear and to take a view on the advisability of any course of action. Other managers are required to provide Finance with the information to allow such judgements to be made. Financial managers then become not only party *to* but often leaders *in* operational debate and the decisions that follow.

At least, that is how it works in many companies in the UK. The Finance Director is almost always - explicitly or tacitly – the Deputy and main support to the Chief Executive or her/his equivalent and is often seen as the conscience of the whole organisation in matters affecting its health and stability.

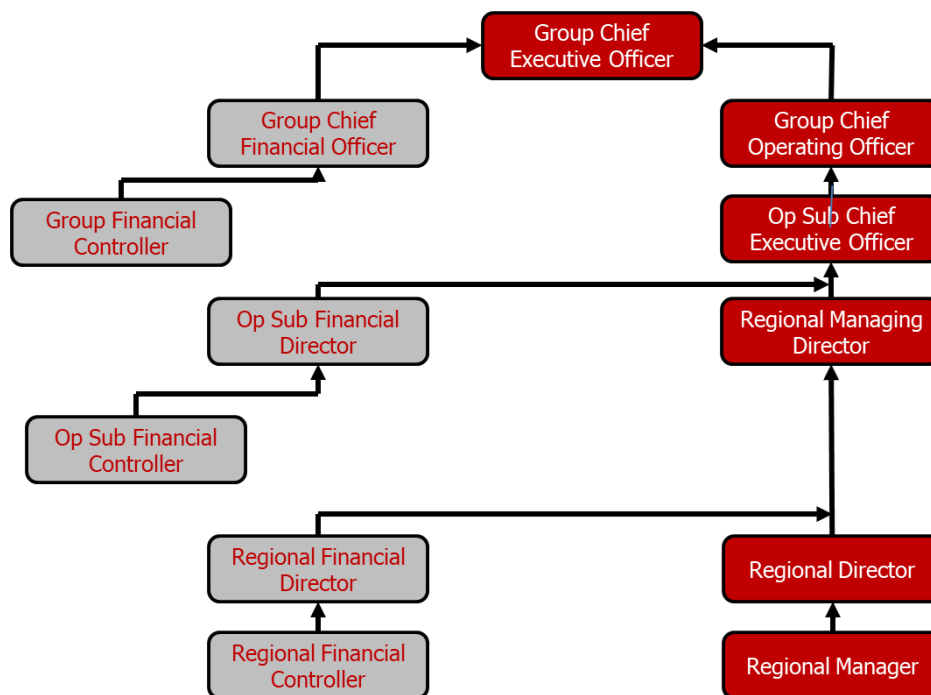
This tradition is not universal. In the United States, for instance, Finance often acts as 'score-keeper' and reporter on financial matters. It is the Chief Legal Officer who sits next to the Chief Executive Officer.

The Appendix summarises the view of the financial function set out by the new financial director of a large group to its incumbent financial managers, before he introduced them to the principles of the financial college he was then setting up. Non-financial managers at all levels, up to and excluding only the Group Chief Executive, are equally bound by these 'rules'. None is likely to be given the power to set them aside.

The particulars in the Appendix may vary from case to case, but the general tone is clear. A healthy business seeks profitability. Managers need well qualified advice on whether any course of action will advance or hinder that cause.

*How the managers and executives in the financial function support general managers in the structure of a multi-level Finance function (the three tiers shown are Group, Operating subsidiary, and Regional division).*

Conventional line reporting structure for the general management and financial management functions



### 3 The financial veto

If Finance is influential in the organisation, it can be given or may acquire the power of veto over decisions. This readily translates into an effect on policy generally, and on its implementation. But naturally no one financial manager can be assumed omniscient. It is how the power of the Finance function is recognised and operates throughout the organisation that is the distinguishing mark of the financial college.

In that model, this power of veto can be made manifest at every level in the devolved organisation. If the operational managers in any part of it are set on a course of action with financial consequences but fail to convince the most senior financial manager in that part of the organisation of its advisability, the matter is resolved at a higher level. There, the heads of Finance and general managers, together, consider the matter again.

General managers, no matter how elevated in the total hierarchy, should be able to take their financial colleagues with them. They could not justify using their authority to exclude the view of their reporting Finance managers.

Finance managers can never be cast as the poodles of their general managers just because they are subordinate and members of the management team.

The converse of a veto is also true. Having the privilege of knowing, and supporting, a decision of the general manager, the Finance manager shares responsibility for the outcome. There is no power without responsibility.

In a financial college, the veto puts a brake on unilateral decision-making by general managers. This is deliberate. It is intended to be like an ever-present, goad, reminding him that all initiatives, investments, budgets, plans, and so on must sustain or recover financials returns, then drive them up to and beyond the targets set for business performance. But why should a device such as this be necessary?



Subordinate Executives, such as the heads of operating subsidiaries, divisions, and regions in a devolved organisation, often have incentives to achieve performance. And in truth, few do *not* strive to maximise profit or hit budget.

But there is more than one way to skin a cat, or to boost a profit. Two pairs of eyes – or ears - used independently are better than one pair. For example, decisions about the budget can be too subjective if all the assumptions and conclusions it embodies depend on a lone general manager, however talented.

The financial veto, on the other hand, generates two independent opinions. If they converge, the outcome is more likely to be a better balanced decision in which all risks have been considered and assumptions backed by a properly articulated rationale. Budget reviewers at a higher level are entitled to ask 'Are these propositions and forecasts supported by Finance?'

## 4 The College

### 4.1 Dual role of Finance

The strength of the financial manager does not reside in the veto itself. It is in that manager's voice as the representative of the financial college of which she or he is a member. It is a double role. The financial executive in a 'line' management team also plays an equally important part as a member of the 'vertically layered' Finance team.

If unconvinced about the wisdom of a business decision proposed by the general manager, the Finance manager has not just an opportunity but also a *duty* to refer the matter up to the financial colleague at the next level. And that is generally understood. Or the matter can be referred downwards to more junior members of the financial brotherhood – the College – for more information.

There should be no confidentialities between Finance and general managers at any level that cannot and should not be shared with the financial executive at the next level in the group hierarchy. The emotions of divided loyalty have no place. Mutual pursuit of the greater business good should be understood as a matter of corporate culture.

### 4.2 Referral through the College

Before taking issue with any weighty business decision in one part of the organisation, a financial executive is likely to take counsel with a senior colleague in the 'college'. Judgement is required here. A financial executive who constantly refers matters upwards may be thought to lack confidence either in his or her own ability to make sound calls on business issues or in her or his general manager's. Conversely, a dearth of contact up and down the college would also raise questions. Has the financial executive forsaken her or his college colleagues and gone native?

Or maybe it really is the general manager who lacks a proper business grounding. Either way, a discourse between Finance and general managers at the higher level would be likely to ensue. The important thing is that the problem would be raised sooner than it might otherwise be, and at the level that should lead to the best resolution.

The Finance manager is entitled to the same exchanges with the financial manager(s) below him: with those in the line or with those in the college.

### 4.3 Effect on behaviour and compliance

In time, contact between the members of the college strengthens compliance with corporate behaviour and rules. Traditions develop. For example, one company is known to believe in remitting actual or potential bad news upwards quickly. At first, this is up to the general

managers. But any delay in reporting bad news could result in the College getting it out first at the right level. No general manager would want that to happen too often.

Colleges engender conventions. Some prompt a conservatism in matters such as inventory, write-offs and forecasts: in others there is supervision of corporate rules on the authorisation of capital expenditure and what may be written-off against revenue.

Games, manipulative behaviour and other sorts of deviousness need little policing when there is a financial college, because the openness of the regime makes non-compliance and collusion difficult and therefore rare. This transparency can be a great comfort to Chairman, Group Chief Executives and Board members.

#### 4.4 Financial careers

Constant involvement in business decisions produces financial executives of superior experience. But the successful operation of a financial college depends on recruiting people of significant financial skill matched by more rounded aptitudes. At some stage in their careers many should be looking like potential business leaders.

While financial managers in some jobs line report to non-financial managers, the latter share responsibility for recruitment and for managing professional aspects of financial jobs with a relevant member of the financial college. The college will have standards and procedures for recruiting candidates of the right sort at all levels of entry. These will include job specifications, starting salaries, requirements for professional background, and training. There should be an involvement in final selection. This interest should continue in the years that follow. The structure for pay and benefits, continuing professional development, performance and career reviews, and promotion prospects will be determined, if not always done, by senior members of the college. One college member in particular may be designated to agree on these standards and procedures with the human resources and appropriate general managers.

Career paths for successful financial managers lie most obviously in a vertical progression. But having the right to be close to business decision-making will school some of them to become general managers of the sort they will formerly have been working to support, and over whose decisions they have hitherto been making judgements. The financial college is good for financial careers.

### 5 Structure

#### 5.1 Dotted-line responsibility

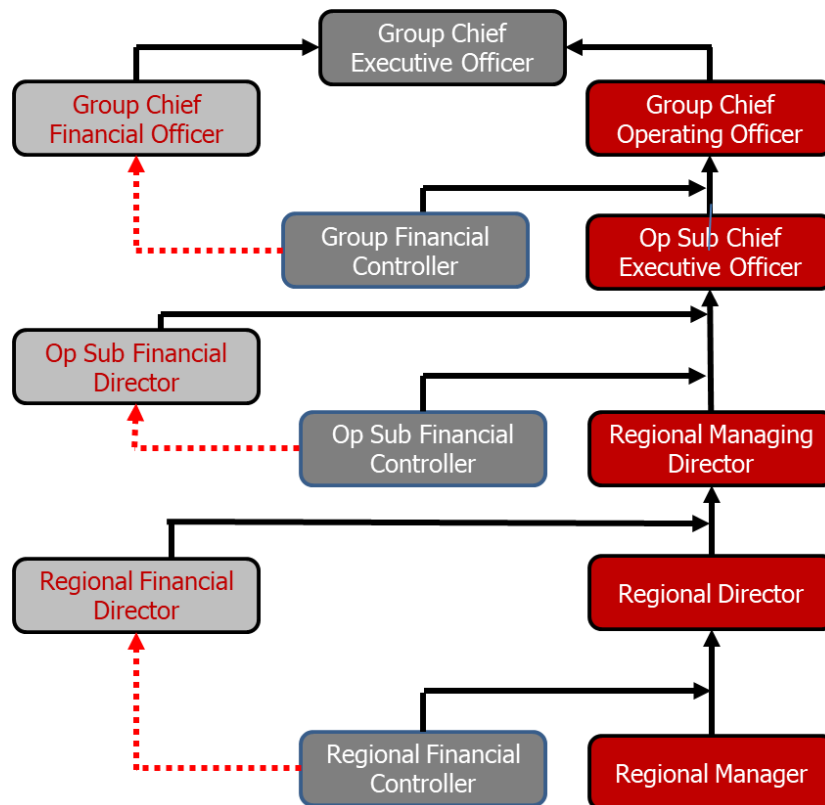
In a devolved organisation, an operational head - say of manufacturing or sales - is often supported by a financial manager or 'controller' to produce monthly accounts and routine reports, comparing performance with budget and doing investigation.

He or she is expected to be steeped in the business of the department and, in compiling its budget, to acquire valuable experience and an excellent understanding of the financial and operational factors that make for its success. But the creation of the budget assumptions themselves usually lies beyond that brief.

In conventional organisations these jobs report directly to the departmental or divisional head, with a 'dotted line' to the financial director or to a financial controller positioned centrally in the organisation. This is illustrated below.

*How the managers and executives in the financial function support general managers in the structure of a group multi-level Finance function (three tiers shown are Group, Operating subsidiary and Regional division).*

Conventional line reporting structure for the general management and financial management functions. Dotted red lines are functional relationships and the blue are line reporting relationships



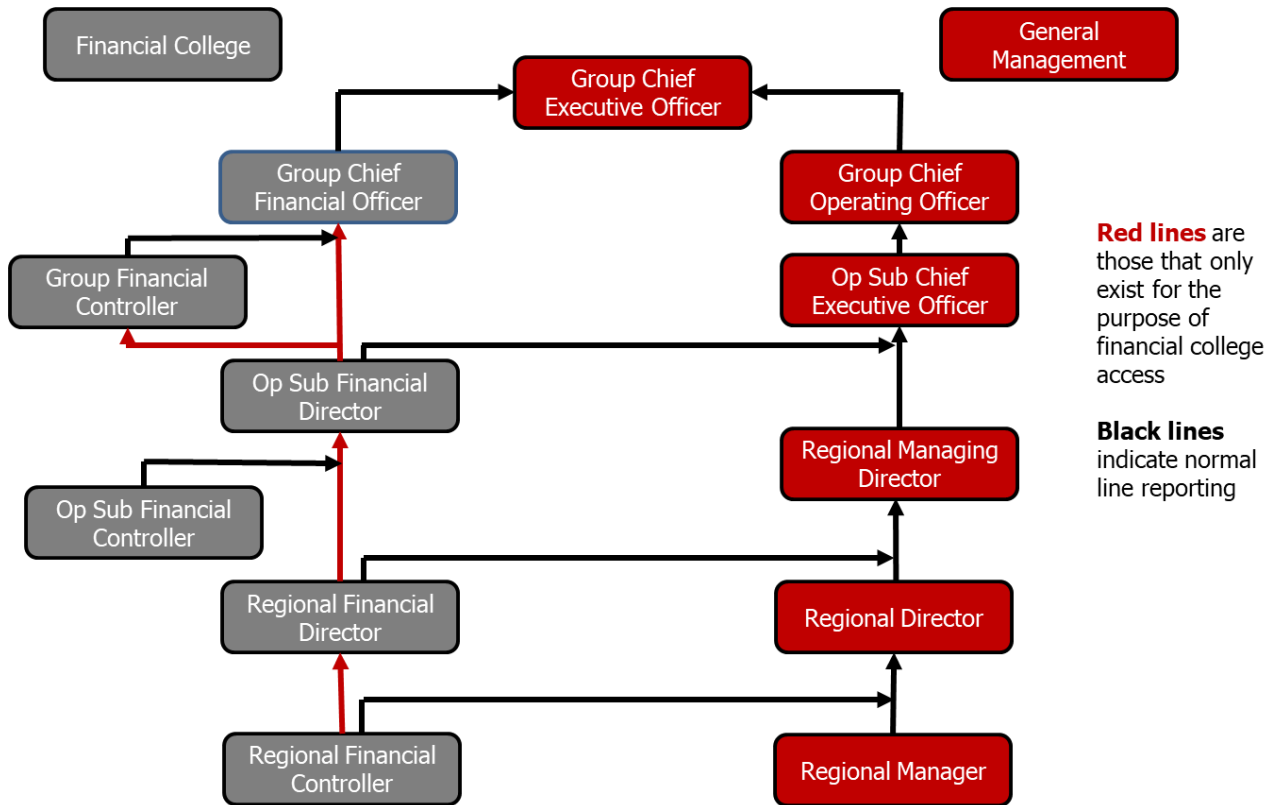
Nevertheless it takes more than these responsibilities, and dotted lines, to constitute a financial college.

Note that nothing in the structure described above, or in the structure of the financial college described below, constitutes an argument for or against any shared financial services that might sensibly be considered.

## 5.2 College structure

The diagram below illustrates how a financial college might be configured in a group with an operating subsidiary that has a regional structure.

*How members of a Financial College are positioned in the structure of a group multi-level Finance function (the three levels shown are Group, Operating subsidiary and Regional division).*



Note the power of the Group Financial Controller, who is given the same access to the Operating Subsidiary Financial Director as to the Group Chief Financial Officer. Some variation in the structure is possible, case by case, but the theme linking members of the College is clear. In conclusion

The red lines on the diagram above show the strength that a financial college gives to an organisation:



Forecasts and recommendations in a proposal, report or letter are made in good faith and on the basis of the information before us at the time. Results depend on the effective co-operation of the client and the client's staff. Therefore, no statement in a proposal, report or letter is a representation, undertaking, warranty or contractual condition. This Company shall not be liable for any losses which were not reasonably foreseeable on acceptance of a proposal or for indirect or consequential losses including loss of revenue, expected profits and claims by third parties.

## The typical organisation and responsibilities of a financial function

The following policies and practices – a real example - would serve as a model for the financial college.

- The financial staff should lead the corporate financial reporting function. They should also interpret the results, assess performance and advise managers at all levels.
- There needs to be a strong emphasis on recognising problems and priorities for action to improve results; and on suggesting how problems might be resolved.
- Priorities for these matters should be associated with sales margins, unit costs and measuring ratios and other indices of performance.
- The financial staff should be involved in all business decisions before they are taken, and should be expected to have and to express views.
- The Finance function should be devolved into small, well dispersed teams in which many people are allied with operational counterparts.
- The entire financial staff should have access to and regular exchanges with all other financial teams above, below and alongside them.
- Accounting standard practice should always be to take a prudent approach in writing off the cost of assets, the costs of non-conformance, accruals, provisions et cetera.
- Possible and actual losses should be provided for at the earliest opportunity.
- Bad news should be communicated without delay.
- Rules on capital expenditure should be made very clear and strictly enforced. Writing off what is properly capital cost against revenue should be forbidden.
- The authorisation of capital expenditure should follow a mandatory process that requires a business case, a calculation of cash flow cover and other proofs to assess whether the required returns will be achieved.
- The budgeting process should be thorough. Its integrity in all parts must be demonstrated beyond doubt. Evidence for the assumptions made must be simple, explicit, demonstrable, backed by the commitments of the relevant managers, realistic and achievable.
- All managers, led by the Finance staff, should strive to use a minimum of working capital and must account for it.
- The accounting system should have the minimum necessary nominal codes, and generally strive for simplicity in all matters.
- A few vital statistics should be produced weekly – sales, finished goods, new orders et cetera.
- The monthly accounts timetable should include flash data, performance reports accompanied by variance analysis, interpretation of business issues, and latest estimates of the year-end result.



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