Chapter 1

The roles of finance function in organisations

Chapter learning objectives:

Lead	Component	Indicative syllabus content
A.1 Explain the roles of the finance function in organisations.	Explain how the finance function: (a) Enables organisations to create and preserve value (b) Shapes how organisations create and preserve value (c) Narrates how organisations create and preserve value	• The fast-changing and unpredictable contexts in which organisations operate • Enabling value creation through planning, forecasting and resource allocation • Shaping value creation through performance management and control • Narrating the value creation story through corporate reporting • The role of ethics in the role of the finance function

1. Introduction

By the end of this chapter, you should understand how the finance function enables, shapes and narrates value creation through its five roles:

- Planning
- Forecasting
- Resource allocation
- Performance management and control
- Financial (corporate) reporting

These roles are changing due to the continuous change that is impacting organisations. Before we look at the roles of the finance function, we should take a look at change.

The chapter concludes with a discussion of ethics and corporate governance. These underpin an organisation's sustained value and are therefore related to the finance function's role in value creation/preservation.

2. Change: the new norm

Change is the new norm in many organisations due to seismic shifts in the level of competition, customers' expectations, the global political outlook and fast-paced technological change.

- These changes present both risks and opportunities.
- They will impact the organisation and the finance function within it.

3. Introduction to the finance function

Different types of organisation

	PROFIT ORIENTED	Not-For-Profit ORIENTED
Primary objective(s)	Maximise owner wealth	Maximise benefits to beneficiaries
Secondary objective(s)	Detailed objectives as to how to maximise owner wealth	**Economy** (controlling costs) **Efficiency** (achieving objectives at minimum cost) **Effectiveness** (a measure of achievement by reference to objectives)
	Companies (Ltd and plc) Sole traders Partnerships	Public sector Private sector

The functions of an organisation

The main functions of a business are:

- operations
- sales and marketing
- human resources (HR)
- IT
- finance

Three basic types of resource – material, labour and money – are used to produce goods and services, which generate profit.

It is a major part of the finance function's work to **look after the business' money**. The finance function's role in managing the financial resources of the organisation and providing information to help economic decision-making will be integral to the effectiveness of the finance function.

The roles of the finance function in organisations

1st role **It ENABLES organisations to create and preserve value**	**Planning** – the finance function prepares plans (such as budgets) to help the organisation achieve its objectives and to set relevant strategies. **Forecasting** – the finance function will prepare forecasts, for example of future sales or material prices. **Resource allocation** – the finance function will work out which resources (such as labour and finance) are needed to achieve the organisation's objectives.
2nd role **It SHAPES HOW organisations create and preserve value**	**Performance management** – the finance function has an important role in managing performance and in ensuring the organisation achieves its plans and budgets. The function will establish appropriate performance measures and monitor these. **Control** – differences between the planned and actual performance will be identified by the finance function (using variance analysis), perhaps leading to a reassessment of the originals plans, strategies or budgets.
3rd role **It NARRATES HOW organisations create and preserve value**	**Financial (corporate) reporting** – the finance function will prepare comprehensive reports for shareholders and other interested people about the organisation's activities and performance throughout the year.

4. The role of ethics in the role of the finance function

Ethics is the system of moral principles that examines the concept of right and wrong.

- Ethics underpins an organisation's sustained value creation.
- The roles that the finance function performs should be carried out in an ethical way.
- The professional accountant has a special role in promoting ethical behaviour in the business.

Business ethics is the application of ethical values to business behaviour.

Business ethics is important for a number of reasons:

- It will be favoured by:
  - customers, resulting in higher sales,
  - employees, resulting in attraction/retention of the best employees,
  - business collaborators, resulting in increased opportunities.
- It reduces risk and gives access to cheaper funds.
- Unethical behaviour, if exposed, may impact reputation and result in costly legal fees.

An **ethical dilemma** involves a situation where a decision-maker has to decide what is the ‘right’ or ‘wrong’ thing to do.

Some examples:

- Accounting issue: creative accounting to boost or suppress reported profits
- Production issue: should the company test its products on animals?
- Sales and marketing: price fixing

CIMA's ethical guidelines

As a member of a professional body, the accountant has a duty to act in the interests of the public at large, as well as of the business and its owners.

In order to achieve the objectives of the accountancy profession, CIMA qualified accountants have to observe five fundamental principles:

- **Integrity.** Being straightforward, honest and truthful in all professional and business relationships. You should not be associated with any information that you believe contains a materially false or misleading statement or which is misleading by omission.
- **Objectivity.** Not allowing bias, conflict of interest or the influence of other people to override your professional judgement.
- **Professional competence and due care.** An ongoing commitment to your level of professional knowledge and skill. Base this on current developments in practice, legislation and techniques. Those working under your authority must also have the appropriate training and supervision.
- **Confidentiality.** You should not disclose professional information unless you have specific permission or a legal or professional duty to do so.
- **Professional behaviour.** You must comply with relevant laws and regulations. You must also avoid any action that could negatively affect the reputation of the profession.

Why business ethics are important

The professional accountant has a role in promoting ethical behaviour within an organisation. Businesses are part of society. Acceptable business ethics may comprise, at a minimum:

- paying staff decent wages and pensions,
- providing good working conditions for staff,
- paying suppliers in line with agreed terms,
- sourcing supplies carefully,
- using sustainable or renewable sources,
- being open and honest with customers.

Ethical behaviour is likely to be favoured by

- customers
- employees
- business collaborators

Corporate code of ethics

Many organisations have a written code of ethics in place:

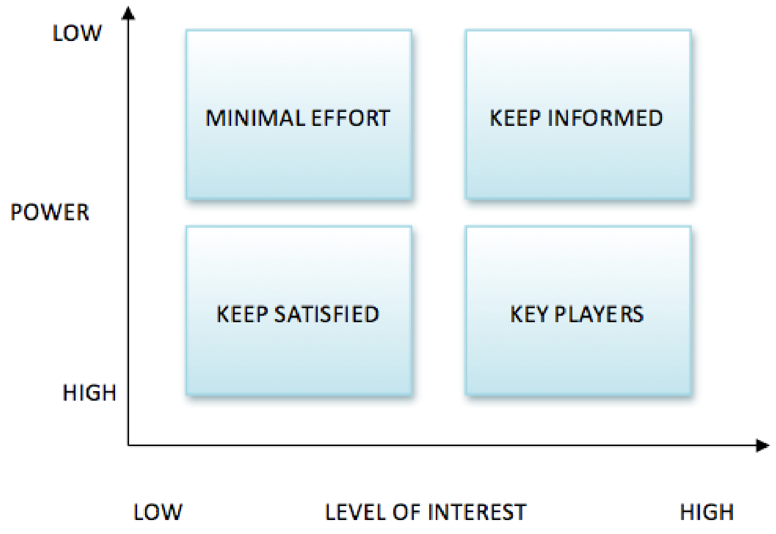
- A set of internal policies for employees to follow
- May be **broad** generalisations (**a corporate ethics statement**) or can contain specific rules (**a corporate ethics code**)
- No standard list of contents but may contain guidelines on issues such as honesty, integrity and customer focus
- Many organisations appoint an Ethics Officer (Compliance Officer) to monitor the application of the code and to be available to employees to discuss ethical issues

Corporate social responsibility

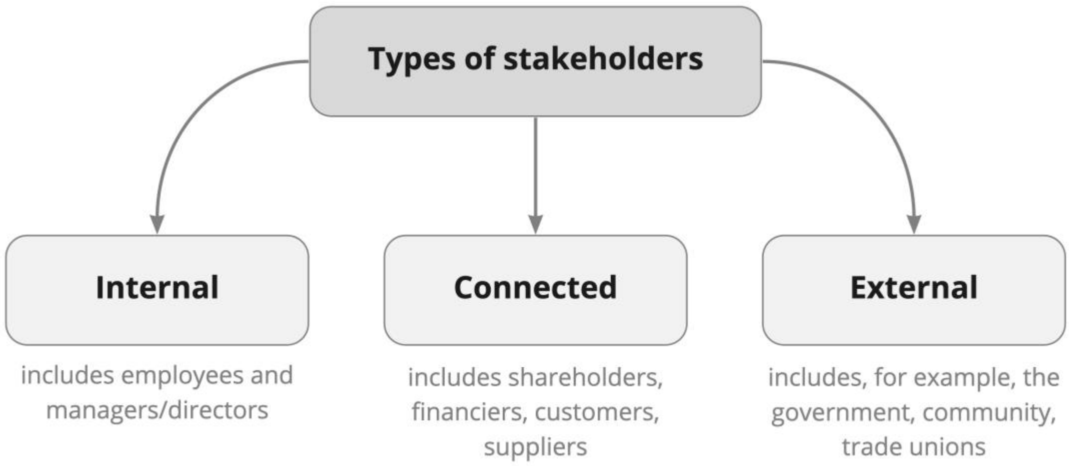
A stakeholder is a group or individual who has an interest in what the organisation does or an expectation of the organisation.

If an organisation is having difficulty deciding who the dominant stakeholder is, they can use Mendelow's power-interest matrix.

Stakeholders Mapping: The Power Interest Mapping



Stakeholders can be broadly categorised into three categories:



CSR means that the company is sensitive to the needs of all stakeholders and not just shareholders. As such, business ethics is just one dimension of CSR.

Why do companies want to engage in CSR?

- It is a source of differentiation.
- It attracts and retains high-calibre staff.
- It helps with brand strengthening.
- It can reduce costs (for example, due to less energy usage).
- It enables the identification of new market opportunities and changing social expectations.
- **There can be an overall increase in profitability as a result of the above.**

Test Your Understanding 1: Ethics

Which ONE of the following statements would be incorrect?

A. Ethical considerations underpin the concept of Corporate Social Responsibility (CSR).

B. Acceptable ethical behaviour does not vary between different national and organisational cultures.

C. Corporate Social Responsibility (CSR) refers to the idea that an organisation should be sensitive to the needs and wants of all its stakeholders, not just its shareholders.

D. Business ethics comprises the principles and standards that govern behaviour in the world of business.

5. Corporate governance

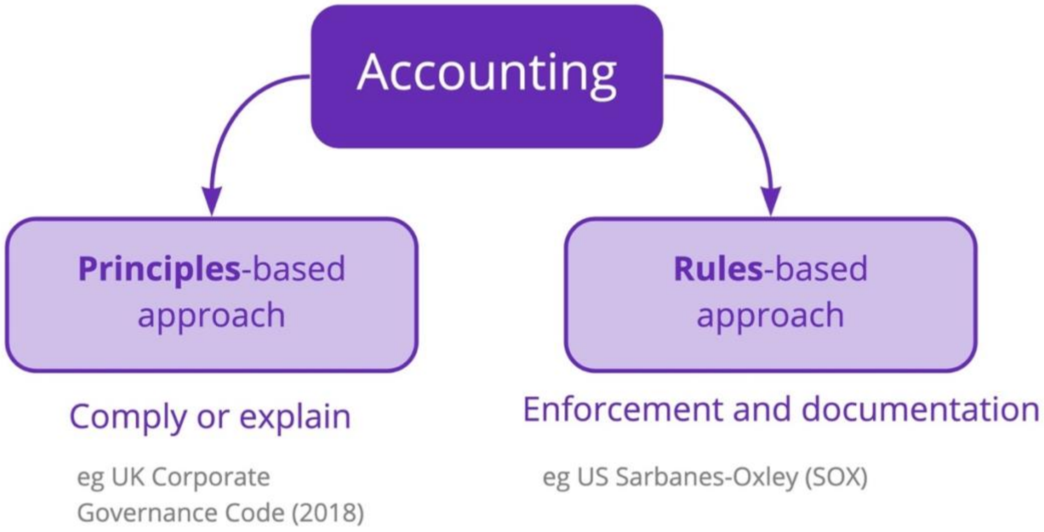
Corporate governance is the set of processes and policies by which a company is directed, administered and controlled. It includes the appropriate role of the board of directors and the auditors of the company.

- Corporate governance has become a major business issue, driven by a succession of public 'scandals'.
- The need for corporate governance arises because, in the majority of organisations, there is a separation of ownership and control, i.e. the people who own the company (shareholders or 'principals') may not be the same as the people who run the company (the board of directors or 'agents').
- This separation can bring benefits, but there is a risk that the directors may run the company in their own interests and not in the interests of the shareholders – ***the agency problem.***
- Corporate governance is concerned with the overall control and direction of a business so that the business's objectives are achieved in a manner that is acceptable to all stakeholders.
- Governance should lead to sustainable wealth creation.

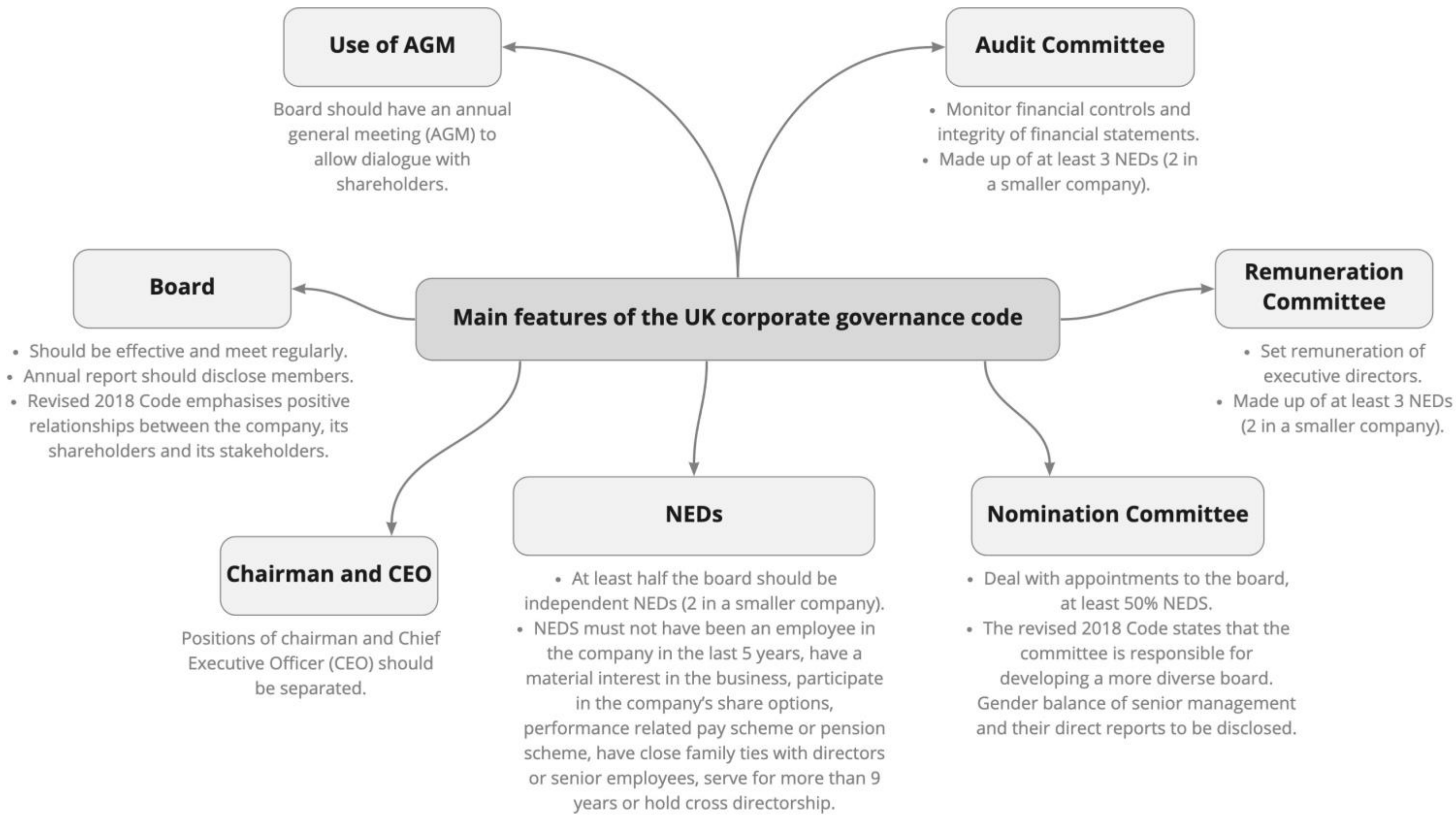
The importance of corporate governance

- Companies are required to follow local governance rules to qualify for stock exchange listing.
- Corporate governance codes have been developed from the UK governance codes.
- The UK follows a principles-based approach, whereas the US follows a legislative (rules-based) approach.

- Corporate governance helps reduce risk.



Features of the UK corporate governance code



6. Solutions to Test Your Understanding

Test Your Understanding 1: Ethics

The correct answer is B.

This statement would be incorrect. Ethics might be viewed as a set of moral principles that guide behaviour based on what is felt to be ”right”. As opinions may vary over what is “right” and what is “wrong” ethics is, in many ways, a subjective concept. Individuals have their opinions on “right” and “wrong”, and ideas can vary enormously between different national and even organisational cultures.

7. Chapter summary