

THE APPLICATION OF PROCESS-BASED APPROACH FOR FINANCIAL STRUCTURE CONSTRUCTION

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Abstract

An effective system of activity planning, company's resource and potential measuring is an indispensable condition for realization of company's strategic aims amidst dynamic business environment. Development of company's financial structure serves as a basis of company's division activity coordination for the benefit of unitary resulting effect.

The notion of financial structure as a tool of company management by delegation of authorities and substitution of administrative approaches for economic ones (business unit management) is common in economic and scientific literature. In given article the author presents a financial structure as a tool of combined process-based company management system. The aim of present article is the development of theoretical basis for construction of financial structure of a large multi-field enterprise in service industry, which will provide an opportunity of effective financial management both for independent business processes and the company on the whole.

The result of the article is an author-developed construction scheme for financial structure as a part of combined management model for an enterprise in service industry with company management process-based approach as a conceptual basis.

Key words: *process-based approach, process-oriented model, strategic aims, financial structure, responsibility center.*

1. Introduction

Activity success of a modern company largely depends on management process organization extent inside the company under conditions of territorial expansion and physical growth of companies, production process complication, supplier proliferation, changes in customer relations and a highly competitive environment.

The financial structure of a company, as a part of combined company management model, based on process-oriented approach using modern management tools, can become a foundation for management process ordering and a creation of harmonious system of planning and control, company's potential and asset estimation.

Absence of theoretically and methodologically developed system of constructing a financial structure, as company management tool, in which strategic aims are detailed to the level of business processes, determines the relevancy of present article and the practical need for such system in companies of Latvia.

The aim of given article is the development of theoretical basis for the construction of financial structure of a certain multiproduct service industry enterprise in Latvia, based on economic literature and scientific publication study, analysis and evaluation. The development of theoretical basis of constructing a financial structure involved consideration of the following issues in this article:

- * Interrelation of financial and organizational structures;
- * Tasks of financial structure;
- * Stages of financial structure construction (scheme).

The product of the article is an author-developed scheme of financial structure construction as a part of combined service industry enterprise management model, with conceptual basis presented by process-oriented approach of company management.

Provisions and conclusions from the modern management tool-related publications of the leading scientists, specialists and experts formed the methodological and theoretical basis of work. Besides this, the given research is a part of author's study into management system creation, which is oriented on value engineering using advanced management tools for a certain enterprise in service industry, as part of doctoral thesis.

2. Interrelation between the Financial and Organizational Structures and Tasks of Financial Structure

When constructing a financial structure of a company, it is essential to understand the way it will be associated with company's organizational structure.

The notion of company's structure supposes a hierarchic system. The elements of organizational structure as a hierarchic system are represented by the functional structural subdivisions of company. The physical progress control of any actions is the basic lever of the organizational structure as a tool of functional management. (Боровков, 2006) Under conditions of vigorous growth of companies, the origination of various business lines inside structural subdivisions, functional approach and organizational structure therewith do not provide business efficiency and the company loses the sight of its development prospective.

The coordination of company's activity aims and methods of achievement can be based on a financial structure, which is just a single section of company's management structure. Responsibility centres are the elements of financial structure as a hierarchic system (Миславский, 2005). Financial structure of a company is a tool of company's financial planning, activity control and analysis. Apart from organizational structure, which reflects the subordination hierarchy inside the company, financial structure represents the hierarchy of responsibility for equalling financial performance. Financial structure of a company is constructed on the basis of economic and financial relations between responsibility centres; therefore, expenses and incomings of certain type are grouped in responsibility centres. Business logic is the logic of constructing a financial structure. In turn, personal factors and inside schemes are often considered, when constructing an organizational structure.

In practice, organizational and financial structures of a company are closely related, but not necessarily congruent. Modeling of a financial structure almost always allows detecting deficiencies of organizational structure, which were formed in company's lifetime: function duplication, or, on the contrary, weak and ignored links of business processes.

Creation of a financial structure allows tracing asset flows inside the company and assessing efficiency of business in general and its elements, so the major tasks of a financial structure could be:

- * Division of responsibility for the final result of company's activity;
- * Coordination of company's subdivision activity on operative and strategic levels;
- * Assessment and efficiency control of various business lines of company, which is urgent for multiproduct companies.

The performance of tasks assigned above could become a foundation for construction of budgeting system (Ивлев, Попова, 2005), management accounting, objective estimation of company's assets and potential, as well as the effective system of employee motivation. This is what the author of the article views the practical meaning of financial structure construction in.

3. Construction Stages of Financial Structure

Generalizing the methodological and theoretical principles of constructing a financial structure, which are described in scientific literature, and taking process-oriented approach as a basis, the author presents the following stages of financial structure construction:

Preparatory stages

1. Identification of business processes;
2. Activity type classification within the bounds of business processes;
3. Allocation of cost and revenue items according to activity types;

Direct modelling of a financial structure

4. The allotment of responsibility centres by the character or of economic indicators;

Final stage

5. Organizational stage.

3.1. Identification of Business Processes

The first stage of financial structure creation supposes making a list of business types (Хруцкий, 2009), i.e. the identification of company's business processes. Considering a company as an assembly of business processes, it is essential to classify these processes. It is useful to consider the classic concept of value chain, in which all processes are divided into basic and supportive ones, as a basic model of conducting analysis. Basic processes are divided into processes of inbound logistics, basic operations, outbound logistics, sales and marketing and service processes. Supportive processes are represented by procurement processes, technology development, human resource management, and company infrastructure. (Porter, 1985).

Business process classification scheme can be developed by the company itself, using process scheme under terms of quality management system (ISO), or using already developed methods. For instance, business processes can be divided into basic (operational) and management and support processes according to the method of company Artur Andersen and American Productivity & Quality Center (APQC) (APQC PROCESS CLASSIFICATION FRAMEWORK, 2009). If necessary, the classification of processes can be detailed to the level of subprocesses.

3.2. Activity Type Classification

To modulate a successful financial structure, the company must have a clear vision of its activity types, i.e. the operations of converting incoming resources into output results (Ивлев, Попова, 2007). The classification of activity types is the second stage of financial structure creation. It is helpful to subdivide activity types into primary, secondary and design ones. In case when activity type definition is too general, it is subdivided into subtypes. (Brimson, Antos, Collins, 2004)

Primary types of activity are aimed at the assigned task completion. They are measured by quantitative result. Supportive activity types of primary ones are referred to secondary types. Theoretically, they must increase the efficiency of primary activity types. Design activity types are characterized by time limitations and have start-end dates.

The assembly of all activity types represents a model of production process (business process). "Management gurus", Michael Hammer and James Champy, treated the notion of business process the following way: "By "process" we mean a set of operations (activity types), which altogether create a result that is of value to for a consumer – for example, the development of a brand new product". (Hammer, Champy, 2001).

3.3. Cost and Revenue Item Allocation in Accordance with Activity Types

Model of company business as an assembly of business processes and activity types, gives a clear vision of asset routing inside the company and shows, who are they influenced and controlled by and how. This gives an opportunity to allocate cost and revenue items by business processes and activity types, to define regulated and unregulated cost items on the next (third) stage of financial structure construction.

3.4. Responsibility Centre Allocation

The essence of creating a financial structure lies in identification of subdivisions that can bear the responsibility for asset flows inside the company. Every structural element of a company attracts income and/or undertakes expenditures contributing to the final financial result. Consequently, when planning activity and reporting the results, the subdivision is responsible for its actions. Dividing the responsibility between subdivisions this way, it is possible to assess activity results and coordinate their actions. Hierarchy of responsibility for the final result is the basis of a financial structure.

Responsibility centres are elements of a financial structure. There are various principles of responsibility centre classification in economic literature. For example, by target values, on

which the activity of responsibility centres is oriented (Кочнев, 2008), in accordance with chief authority and responsibility (Молвинский, 2006), as budgeting objects (Хруцкий, 2009). In author's opinion, it makes sense to use company group "ИНТАЛІЕВ" "Budgeting and management accounting" branch chief's, P. Borovkov's offered classification of responsibility centres by the pattern of economic indicators, which the according centres are responsible for. (Боровков, 2006). This criterion appears universal, i.e. does not depend on business field, branch and size. Basing on five fundamental types of indicators (revenues, costs, profit and marginal profit over a period, as well as return of investment) it is possible to accentuate five basic types of responsibility: revenue centres (RC), cost centres (CC), profit centres (PC), marginal profit centres (MPC) and investment centres (IC). It is appropriate to specify costs centres to centres of management cost (CmC), with indirect costs of company associated with them, and centres of standard costs (CsC) that are able to control costs per product unit.

The described classification of responsibility centres according to the basic economic indicators is generalized by author in figure 1.

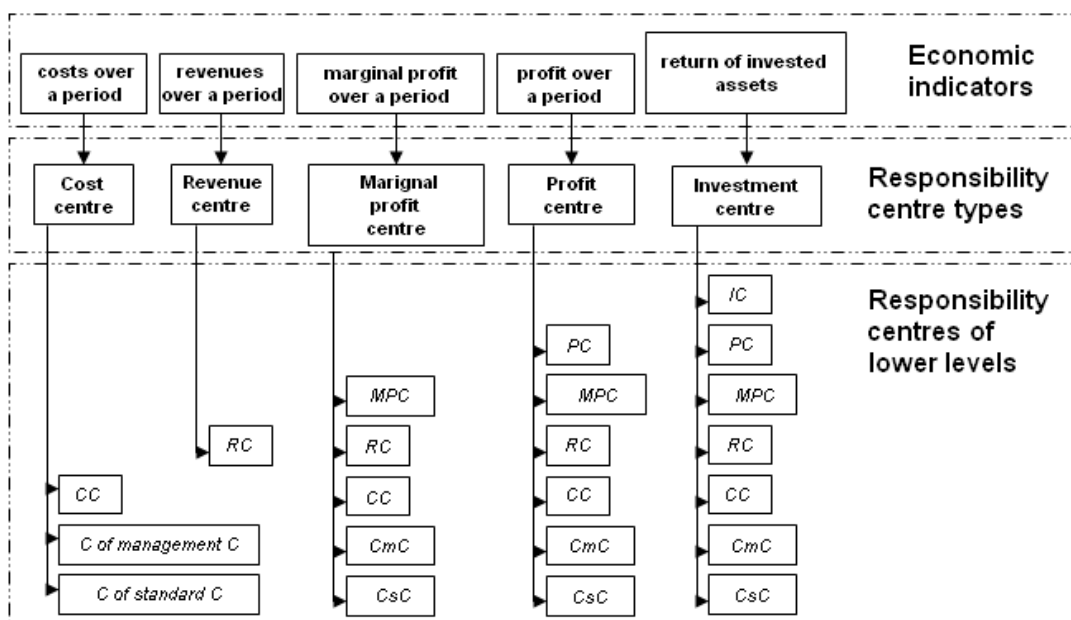


Figure 1: Classification of responsibility centres (designed by the author)

To construct a model of company's financial structure, the peak of the financial structure (responsibility centre of the first level) must be defined. This is usually an investment centre and/or a revenue centre, which is responsibly controlled by top management (managing director). Depending on business type, field, company size, filial branch existence, responsibility centres of next levels are allocated. Organizational and technical opportunities of separate direct cost and revenue recording decide the choice of object to become an element of a financial structure. This is the way the financial structure model of a company is developed.

It must be mentioned that the higher the extent of financial structure specification is, the more precise analytical reports can be obtained. For companies with complicated structure such division can appear difficult, expensive and complex, serious problems can appear when allocating general production and general administrative costs. Compromise must be reached between more precise measurements and a higher cost of data capture, so that data capture cost would not exceed the profit of analysis. For that reason the ratio of specification extent and information gathering and analysis is defined in every case individually, by certain company.

3.5. Organizational Stage

The final stage of financial structure creation is represented by organizational stage that includes a schematic drawing of financial structure, definition of executives responsible for the activity of every responsibility centre, development of codes for responsibility centres, coordination and approval of regulations on company's financial structure.

Company's financial structure, modelled according to the scheme, presented in figure 2, allows completing tasks of optimization and coordination of all business processes, in order to create a rapid flow of assets, actions and information inside the company.

In author's opinion, such approach reveals the following advantages:

- the change of business processes logically leads to the changes in financial structure.

- interrelation between responsibility centres and business processes determines the sensitivity of financial structure to changes in business structures and ability to adapt promptly to the changing market environment.

- in case the stage of problem discussion is excluded throughout all hierarchic chain inside every functional subdivision of organizational structure, management decisions become more operative and reasonable.

Direct use of financial structure as a management tool on the stage of company activity planning and its result verification makes financial structure one of the key links in management process. A precise model of company's financial structure becomes a basis for real planning, activity assessment and, in the long run, for the strategic justification of managerial decisions.

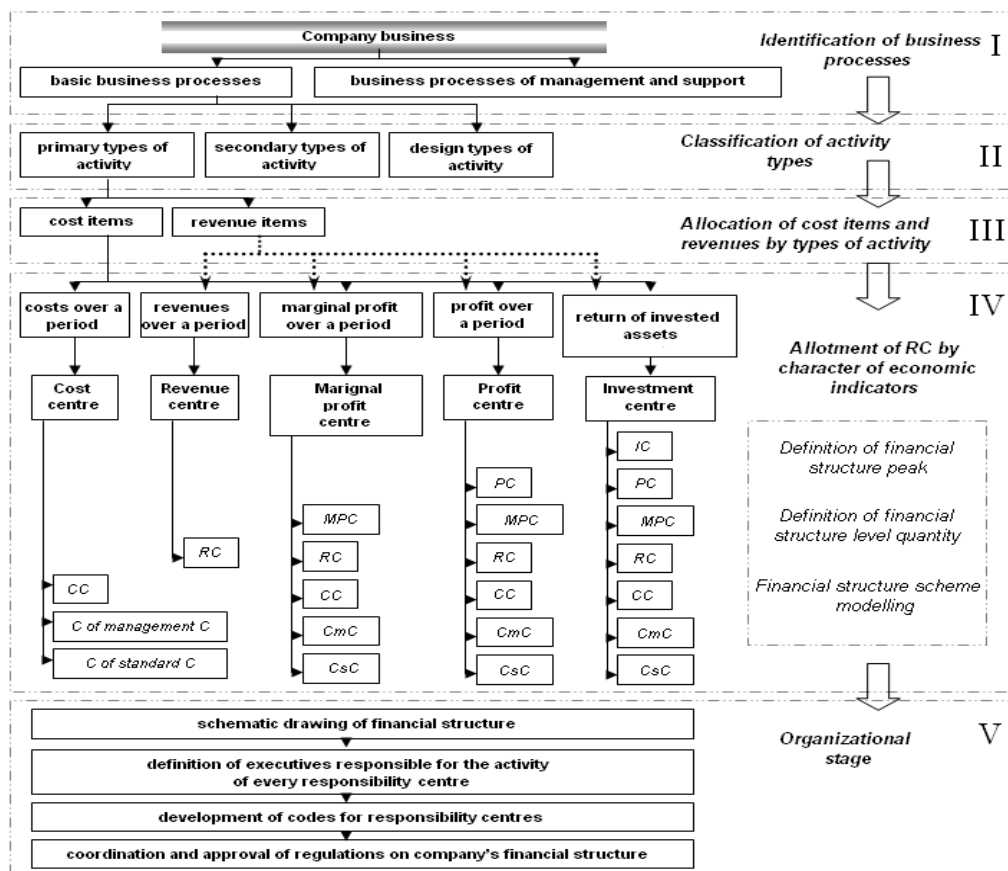


Figure 2: Company financial structure creation scheme (designed by the author)

Conclusions

1. Basing on the study and analysis of publications by leading scientists, specialists and experts in the field of management and planning, the author developed a scheme of constructing a financial structure as an element of combined management model with

process-oriented approach of company management as conceptual basis. With this approach company activity management becomes more flexible, allows rapid responding to the changes in business environment and cutting costs effectively.

2. The presented scheme of constructing the financial structure of a company implies preparatory stages of business process identification and allotment of company activity types in line with the existing classifications. Allocation of responsibility centres on the basis of cost and/or revenue item allotment according to activity types gives a reasonable vision of company from the viewpoint of business efficiency. The final stage supposes organizational events of company financial structure creation.

3. Financial structure, modelled in compliance with the developed scheme, as a tool of flexible response in the changing environment, and a part of the combined company management system provides solving of the following tasks:

1) Gives a clear vision of company's business structure, origins of cost and revenue, hierarchy of responsibility for reaching the final result.

2) Serves as a basis for optimization and coordination of all business processes and for the creation of a rapid flow of assets, activities and information inside the company.

3) Spares the time of company's top managers for solving strategic tasks, transferring responsibility for achieving the final result to the executives of responsibility centres, and, in such a way, helps solving the problem of realization of company's strategic aims.

4) Gives outcome measuring opportunity and coordinates the actions of responsibility centres rapidly.

5) Being a dynamic system for steady improvement makes strategic managerial decisions more reasonable and operative.

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