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Budgeting

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Abstract: *Budgeting is the set of the activities of forecasting the financial demands of company in the future (Garisson, et al., 2003). A budget is a comprehensive plan which depicts the information about acquiring and using resources over a certain period of time. During the Budgeting process the anticipated levels of sales, cash flows and probable costs are assigned by the management (Horngren, 2006)*

Keywords: Budgeting

I. INTRODUCTION

Budgeting is the set of the activities of forecasting the financial demands of company in the future (Garisson, et al., 2003). A budget is a comprehensive plan which depicts the information about acquiring and using resources over a certain period of time. During the Budgeting process the anticipated levels of sales, cash flows and probable costs are assigned by the management (Horngren, 2006). Past research has mainly focused on the budgeting functions of the large corporations that are publicly listed in the developed economies. For instance, Dugdale (1994) reported that UK companies experienced eminent gains by careful planning of their budgetary functions and majority of the Australian companies have systemized and elaborated their planning processes (Bonn and Christodoulou, 1996). In addition or it, it is also determined that strategic planning positively influences the performance of SMEs (e.g. Aram & Cowen, 1990Knight, 1993), but considerable attention is not paid to explore the influence of budgeting process on the performance of SMEs (Wijewardena& De Zoysa, 2001) which makes it an underdeveloped research area that warrants more attention. Budgeting process is adopted differently in firms depending upon their size and organizational diversity (Merchant, 1981)

II. LITERATURE REVIEW

SME sector in India Indian SME sector is central to her economy imparting 40% of exports and adding up to 45% of industrial production. Moreover it provides employment opportunities to approximately 60 million people and yearly creates 1.3 million jobs in India. According to the figures rendered by the Europe India SME business council, there are around 30 million small and medium enterprises in India rapidly growing at 8% annual rate and they are estimated to produce jobs for millions of people in the country (Europe India SME business council).

Growth of Indian SME's has made this sector very lucrative for the foreign and domestic investors. The cutting edge innovative technologies have assisted these small and medium entrepreneurs to add substantial value to their products. The barriers to trade have significantly lessened as different trade portals and directories have made easier to establish contacts between buyers and sellers and thus paved the way for trade to occur. With strong backing from the government, Indian SME sector has excellent prospects to show unparalleled growth rates in the years to come. However industry experts and financial advisors believe that regardless of this phenomenal growth rate, the potential of Indian SME sector has not been fully exploited. The categorization of the small and medium enterprises according to the MSME India (Micro small medium enterprises) is shown in the table 1 below. Table 1: Indian MSME categorization Manufacturing Enterprises – Investment in Plant & Machinery Description INR USD($) Micro Enterprises UptoRs. 25Lakhs Upto $ 62,500 Small Enterprises above Rs. 25 Lakhs &uptoRs. 5 Crores above $ 62,500 & Upto $ 1.25 million Medium Enterprises above Rs. 5 Crores&uptoRs. 10 Crores above $ 1.25 million & Upto $ 2.5 million Service Enterprises – Investment in Equipments Description INR USD($) Micro Enterprises UptoRs.

Performance Measurement in SMEs

The financial aspects of the performance have been employed to a greater extent in order to gauge the performance of the businesses not in SMEs but in also larger firms as they manifest the accomplishment of the economic objectives of

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the firm (Murphy, et al. 1996). . A great deal of accounting literature acknowledges the underlying benefits of financial measures as objective measurement systemcertain to provide a brief view of the achievement of the intended purpose that directly relates with performance of the organization and practicability of its strategies and plans (Hopwood, 1972; Ross, 1994; Kaplan & Atkinson, 1998;
Lau &Sholihin, 2005). Use of financial indicators as a measure of organization's performance is conventionally most commonly exercised accounting tool as it based on the principle of profitability which is one of the significant measureable goal of a firm (Kaplan and Atkinson, 1998). There are several financial indicators that are used as evaluation criteria in assessing the financial performance like profitability, sales revenue, growth and
efficiency (Robinson, 1983; Murphy et al., 1996) The financial ratios employed in this regard are return on assets, return on sales, net profit margin, market share growth, return on investment and change in net income among others (Murphy et al., 1996)

The Formal Budgeting Process

Wijewardena and DeZoysa (2001) characterized the formal process of budgeting in SME's by two aspects, i.e. a formal process of budget planning and a formal process of budgetary control. They further categorized the firms into three exclusive categories. The firms in the first category do not use any type of written budget.
Those in the second group prepare simple budgets with respect to few areas of operation representing a less comprehensive planning process. In the third group are firms using detailed budgets with respect to many different areas of operation. These firms were considered to be engaged in a more comprehensive planning process. In addition, budgeting as management control is also emphasized in their model. Then in terms of budgetary control, the firms falling into the second and third categories are re-classified into three additional categories. Firms in the first category do not calculate differences (variances) between actual performance.

The process of budgetary control

As illustrated in the figure, we can ascertain that the programmable inputs as shown in the budget are equated to the results of the current (i.e. the product) and the variations from the sought after inputs are discovered. The budgetary control model not only asserts the significance of feedback management which includes the restorative actions and required explanations of budgetary deviations, but also a comparison of real results with the budget in order to recognize the deviations. Therefore, it is very essential to measure true performance against planned performance at times and take steps to correct the negative things that cause deviations from the planning perspective (Koontz and

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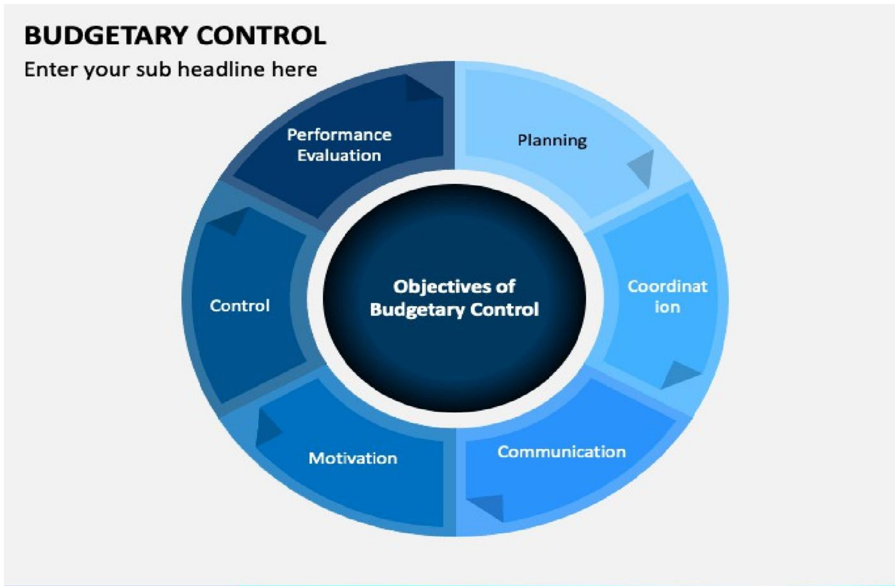
Weihrich, 1998). According to Merchant (1985), the performance of the managers ameliorate when a justifiable explanation for the negative budget deviations is given by managers to their superiors and when managers are actually required to do that, it is eventually in the best interest of the firm (McWatters (2008)



Setting Standards

The first step in effective control is to establish standards against which performance can be measured. These standards should be specific, measurable, and achievable.

Monitoring Performance: Once the standards are established, the organization should monitor its performance to determine whether it is meeting the standards. This involves comparing actual results to the standards.

Taking Corrective Action: If the organization is not meeting the standards, it needs to take corrective action. This could involve adjusting its activities, reallocating resources, or making changes to its processes.

Evaluating Results: Finally, the organization should evaluate the results of its corrective action to determine whether it has been effective in improving performance.

The budget plays a crucial role in each of these steps. It helps to set standards by providing a framework for establishing targets. It also helps to monitor performance by providing a framework for comparing actual results to budgeted results. Budgeting enables the organization to identify areas where it is overspending or underspending and to take corrective action.

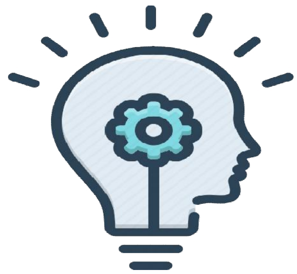
The budget also helps the organization to evaluate the results of its corrective action. By comparing actual results after corrective action to budgeted results, the organization can determine whether the corrective action was effective. The effective control is critical to an organization's success, and budgeting is a key tool for achieving effective control. By following the steps outlined above, organizations can use the budget to set standards, monitor performance, take corrective action, and evaluate results.

Challenges of Budgeting

Despite its importance, budgeting can present some challenges to organizations. One of the main challenges is that budgets can be inflexible. Once a budget is set, it can be difficult to change it, even if circumstances change.

Another challenge is that budgets can be time-consuming to develop and implement. The budgeting process can be complex and involve multiple stakeholders, which can lead to delays and inefficiencies.

Budgets can also create a focus on short-term results at the expen



In conclusion, the budget is an essential tool for effective planning and control in an organization. It helps an organization to prioritize its activities and allocate resources efficiently and effectively. Budgeting helps an organization to plan for the future, manage its cash flow, and monitor its performance.

Despite its challenges, budgeting is a crucial component of organizational success. Organizations that invest in effective budgeting processes are more likely to achieve their goals and objectives.

Effective budgeting requires careful consideration of the organization's goals, objectives, and resource requirements. It also involves collaboration and communication among stakeholders to ensure that everyone is aligned with the budgeting process and its outcomes.

By implementing a well-designed budgeting process, organizations can achieve greater transparency, accountability, and control over their financial resources. They can also be better prepared to respond to changes in their operating environment and to make informed decisions about resource allocation.

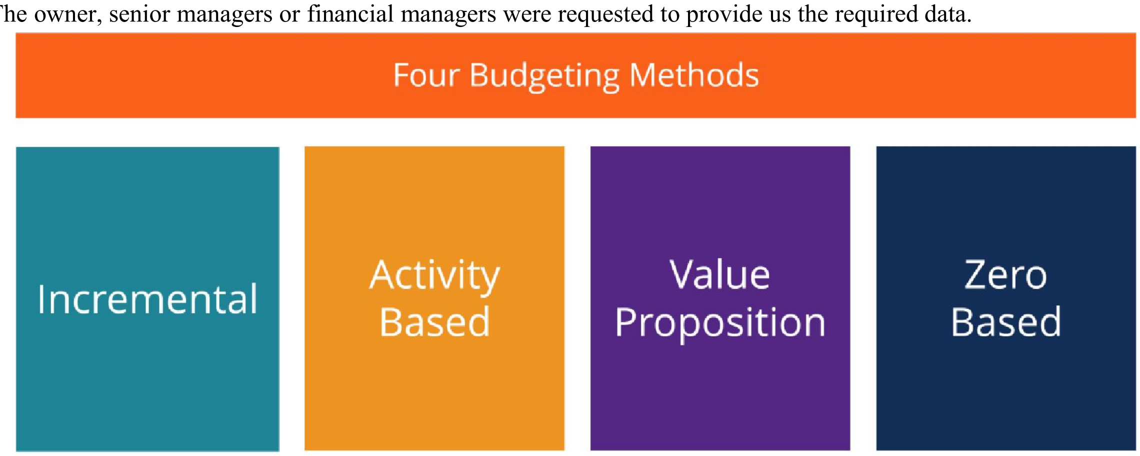
In today's highly competitive and rapidly changing business environment, effective planning and control are essential for organizational success.

Budgeting plays a critical role in achieving these objectives and is a fundamental tool for organizations to manage their resources and achieve their goals.

Methodology

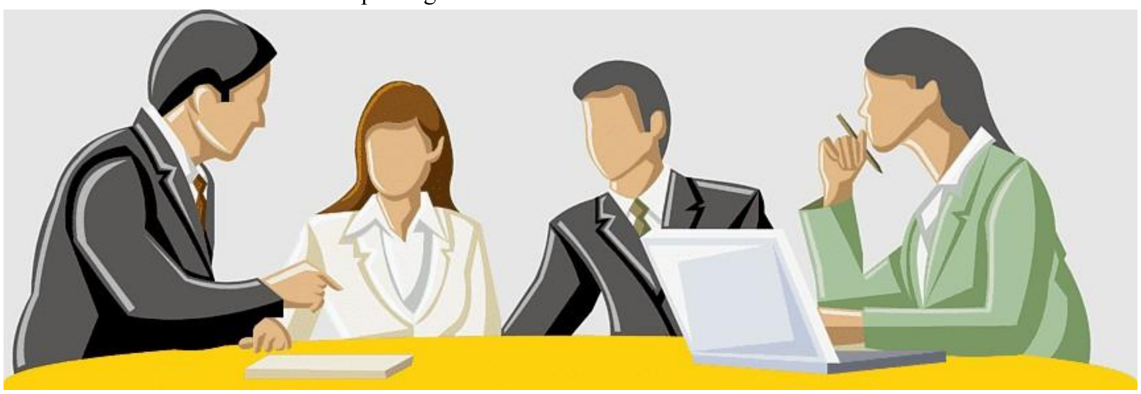
India is one of the emerging countries situated in the south East Asia. In India at presently have 29 states/provinces and 7 areas. Then the federation is further sub-divided into administrative districts, tehsils & villages. The data for this study has been collected from the districts of Mumbai, Pune and Solapur. The reason for the selection of these districts is that these are located in the industrial areas of India and further they constitute extensive manufacturing firms and have higher labor and raw material intensity. Since, these districts are very big and have a large number of small and medium sized companies so it was almost impossible to select the data from all SMEs. However, it was tried to get the data from as many companies as possible. The data has been collected from the

companies' belonging to different industries particularly textile, computer manufacturing, construction, clothing etc. The owner, senior managers or financial managers were requested to provide us the required data.



III. DISCUSSION AND ANALYSIS

completed questionnaies were obtained giving us a response rate 89%. Interviewer administered questionnaire style ensured a high response rate for this studies. A total of 159 responses were collected from district of Solapur (59.3%), 68 (25.4%) from Mumbai district and 41(15.3%) from Pune district. A total of 140 responses were obtained from owners (52.2 %) , 86 senior managers (32.1 %) and 42 financial managers (15.7 %). The bigger the firm size, the more financial managers responded.In terms of business type, there are four types of business in the data, i.e., state-owned enterprise, private enterprise and joint-venture, firms. Strong positive relationship existed between company size and profit growth rate. As the size of the firms increased their profit growth rate also increased. The reason is that firms in their initial years are smaller in size and their focus is more on sales growth rather than on profit growth with due time as their size increase the focus shifts to profit growth. Table 2 reflects the determined values



Description:

Budgeting process on sales growth Hypothesis 2 was accepted as formal budgeting process has a significant relationship with sales growth with t value of 24.258and beta coefficient of 0.664 as shown in table 7. It suggests that more the formality in budgeting process of the firms better would be the sales growth of the firm. Formal budgeting process too has a significant relationship with profit growth with a negative t value that is

-6.452 and beta coefficient of - 0.554 as shown in table 8. It suggests that more the formal budgeting process would have adverse affects on the profit growth of the firm. Hypothesis 4a was accepted as budget goal clarity had a significant relationship with sales growth with t value of 12.811and beta coefficient of 0.351.it suggests that more the budget goal clarity better would be the sales growth of the firm. Budget goal clarity has a significant relationship with profit growth with t value is high positive value that is 4.755and beta

coefficient of 0.409. Hypothesis 3 was not accepted as budgeting control don’t have significant relationship with sales growth with t values of -1.126 and beta values of -0.020. Budgeting control don’t have significant relationship with the profit growth as shown by low t values of -1.050 and beta coefficient of -0.060 respectively. Hypothesis 4b was accepted as budget goal difficulty has a significant relationship with profit growth with a negative t value of -1.185 and beta coefficient of - 0.113. It suggests that more budget goal difficulty better would adversely affect the profit growth of the firm. Budget goal difficulty doesn’t have significant relationship with sales growth with t values of 0.918 and beta values of 0.017

IV. CONCLUSION

The results of current studies indicate that small and medium enterprises working with unclear goals are faced with higher uncertainty in relations to goal achievement, while clear goals reduce uncertainties in the budgeting process, which, in turn, will improve performance of enterprises. When there is clarity on the tasks and goals it promotes a positive vibe throughout the organization. The formal budgeting process has a positive impact on the performance of Indian SMEs. Those firms engaged in more formal budgeting planning have achieved higher growth rate in sales and profit. Strong positive relationship existed between company size and profit growth rate. As the size of the firms increased their profit growth rate also increased. The reason is that firms in their initial years are smaller in size and their focus is more on sales growth rather than on profit growth with due time as their size increase the focus shifts to profit growth. Company size and ownership structure also significantly influence the formal budget planning and budget in the Indian SME's. Sales and budgetary sophistication have a statistically insignificant relationship and budget sophistication relationship with profit is even negative. The underlying reason for this relationship might be that it is very costly for most of the firms in Indian Small and Medium Enterprise sector to achieve a budgetary sophistication level. The sophistication of budgetary tools includes acquiring and installation of costly financial modeling software, training and expensive training and follow up mechanism. This needs a huge investment which is difficult for Small and Medium Enterprises to acquire that much huge investment. If firm goes for these huge investments this increase in their expenses will decrease their net profit value. Budgetary goal clarity has a statistically insignificant relationship with the employee's motivation level and further the budget goal difficulty and employee's job involvement also shows a statistically insignificant relationship. So from these results it can be concluded that there are numerous other factors other than budget goal clarity and difficulty that can motivate and involve that employees in the attainment of budget goal in firms of Indian SMEs sector. This study is limited in its scope as data was collected from only from the three districts of Maharashtra state. And another limitation was that only financial performance was included as an indicator of the firm's performance while non financial performance measures were not included. For future studies the scope can be enriched by studying the SME's in other states of India. And non financial performance measures like employee satisfaction, employee motivation and job involvement can be included to have a comprehensive understanding of the performance.

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