

Budgeting process and performance analysis of vershire



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Company Description and Background

Vershire Company is a diversified packaging corporation with various large divisions. Its most prominent segment; the Aluminum Can division, is one of the largest manufacturers of aluminum beverage cans in the United states. This case focuses on the budgeting process and performance analysis of Vershire. A major concern of the company is pleasing the customers as most of their buyers have several suppliers on hand, meaning that Vershire can be easily replaced if the customer's expectations on quality, cost or service are not met. As a result, efficiency and low costs are top priorities to the company. The main problem of Vershire is that they are treat plants as profit centres instead of expense centres, which is an inefficient measurement of performance for manufacturing plants.

Questions

1. Vershire Company's Planning System

Strengths :

- Divisional managers submit reports to predict outlook on sales and capital requirements five years forward as a part of the strategic planning process. This demonstrates the company's preparedness for future event predictions and its ability to formulate long term goals
- Sales forecasting are formulated at the corporate level and then sent to the divisional managers for analysis and fine tuning. This promotes more realistic and accurate numbers as the managers understand and know how each line functions personally

- Before the submission of budget plans, controller staff from the head office visits each plant to analyze the current operations and gives the opportunity for plant managers to explain their situation and reasoning behind their numbers, improving accuracy and usability of these documents

Weakness:

- Corporate headquarters make fundamental assumptions such as new products, new plants, inventory carry overs, forward buying, and packaging trends, even though divisional managers are responsible for managing the division which lowers the accuracy of the forecast and decrease efficiency due to necessary corrections during review
- All division lines use the same method of forecasting regardless of size, which impedes on the accuracy due to the different customer base, products and demands each line possesses
- District managers determine the sales budgets rather than the plant managers even though it is the responsibility of the plant managers to achieve the goal and is tied to their performance report

Vershire Company's Controlling System

Strengths:

- Divisional managers are given full control over their own business with exceptions to the raising of capital and labour relations which are centralized at head office. This allows the opportunity for divisional managers to make necessary decisions that is specific to achieving their own objectives

- Quick and easy communication between various levels within the organization as there are few tiers in the division
- Consistent effort in meeting the company's budget as large unfavourable variances are to be made aware of on a daily basis by plant managers and variance analysis sheets are prepared monthly

Weaknesses:

- Vershire focuses on profit for measuring the plant manager's performance and to determine bonuses. This analysis tool is not efficient as there are other contributing factors to determine the effectiveness of plant managers

May

Divisional General Managers formulate preliminary report summarizing the outlooks for sales, income and capital requirements for the next budget year and evaluates trends anticipated for the two subsequent years for corporate management

- *Rationale* : Divisional General Managers possesses the most knowledge about their own region and is more equipped to create these documents. It also provides a rough idea of where areas of productions can be improved

Central Market Research staff develops a more formal market assessment, examining the next budget year in detail and the following two years in general terms

- *Rationale:* Uses the information provided by the divisional managers to produce a more refined and detailed market analysis

Central Market Research staff develops separate sales forecasts for each division and a combined forecast for the entire company

- Topics such as economic conditions and their impact on customers and market share for different products by geographical area are taken into account
- Fundamental assumptions are made to price, new products, changes in particular accounts, new plants etc. in order to produce forecast
- *Rationale:* Promotes uniformity in the formulation in all sales forecasts, determine areas for improvement, assesses areas where market share can grow, and ensures that overall corporate sales forecasts were both reasonable and achievable

Divisional Managers compile their own sales forecast from bottom up with input from District Sales Managers to be submitted for review by the Vice President of Marketing

- *Rationale :* To review of the head office's sales forecast and mark any changes and additional investments needed. District Managers' inputs are utilized as they're most familiar with sales (more accurate estimates)

Vice President of Marketing reviews consolidated sales forecasts and submits it to corporate level

- No changes are made unless the district manager agreed who is originally responsible for the forecast

- *Rationale:* Ensures the forecasts accurately reflects both the knowledge of the district manager and the vice president of marketing

Process is repeated on the corporate level (approval from District Manager if needed) until budget figures are approved and become a fixed objective

- *Rationale :* Ensures that all levels of the company is agreement to the calculated figure and that the budget is sufficient to achieve company goals

Overall sales budget is translated and broken down according to the plants from which finished goods would be shipped and sent to Plant Managers

- *Rationale:* Sales budget are sent to these plants as they are the ones to generate revenues

Plant Managers then categorized the budget according to price, volume and end use

- Once categorized, the plant managers budget for gross profit, fixed expenses and pre-tax income
- Can request help for the Industrial Engineering Department to develop cost reduction plans
- *Rationale:* All cost standards and cost reduction targets are developed by the Industrial Engineering, therefore, it makes sure that numbers consistent and reasonable for input

Before the submitting budgets, controller staff visit each plant and review plans with managers (usually takes half a day) until it is finalized and sent to Division Head Office

- *Rationale:* Gives opportunity for plant managers to reason their figures

September

10. Division Head office looks over budget and may return it to Plant Manager if discrepancy is found

- Will ask plant manager to look for any additional savings if the budget is not quite in line with expectations
- When it is finalized, the budget will be sent to the Chief Executive Officer

- *Rationale:* Due to the plant manager having direct experience with the plant's operations, it is necessary for them to make any changes for savings

December

11. Chief Executive Officer makes any modifications to the final budget if needed until it is sent to the Board of Directors for final budget approval

- Final review and ensures that budget is appropriate for corporate goals

3. Plant managers should not be fully responsible for profits as they aren't able to control all aspects of the products' profitability. Since profit is calculated from revenue subtract expenditures, plant managers should only be responsible for expenses, a measure that they can control. This includes direct material and labour, variable manufacturing overhead and fixed overhead budget. Revenues are usually controlled by the sales department; which possesses control

over the price, sales mix, and delivery schedules of products. Also, since the sales manager's opinion is always favoured over the plant manager due to satisfying the customer, it negatively affects the plant manager's ability to control profit and efficiency in output costs.

4. In Exhibit 2, the evaluation system focuses on the profits of Vershire which includes revenues and expenses. Since plant managers have no control over the revenue aspect of products, the information provided does not properly evaluate the efficiency and effectiveness of the plant. Factors such as variances in sales price, sales mix, and sales volume are solely handled by the sales department with no input from plant managers, making results unreliable and irrelevant.

In Exhibit 3, the individual plant level reports give a more detailed insight of the variances shown in Exhibit 2. Once again, it does not provide an accurate representation of the plant's performance as it includes variables that are uncontrollable by the plant manager such as sales. Regarding divisional level reports, the comparative profit performance analysis focuses on net sales while the comparative manufacturing efficiency analysis compares varying sized plants that produce different products together, making it another unreliable and inaccurate source of analysis.

Some changes I would recommend for Vershire company are to redesign how bonuses are given to plant managers as the current measurement mechanisms do not accurately reflect performance, improve comparisons of manufacturing efficiency between different plants due to the varying size and product offering of each plant and improve communication across the tiers in order to minimize error corrections and time for budget reviews.

Possible solutions include organizing meetings to include all managers and corporate levels to discuss about the company's performance, relate manager's performance with cost reduction measures to determine bonuses, and develop a universal measurement unit to fairly compare plants together.

Conclusion

In conclusion, Vershire Company should reconfigure its measurement mechanisms in order to truly analyze the performance levels of the company and begin treating its manufacturing plants as expense centres rather than profit centres. Therefore, Vershire can gather more accurate and reliable information to use for achieving objectives.