Good essay on budgeting and performance measure

Economics, Budget

Introduction

Budgeting is a key aspect in finance management and acts as a guide to organization's planning for management and those involved in operations and running of programs. In that respect, an effective budgeting process is suitable for any organization that seeks to achieve its finance objectives through a suitable resources' allocation. In that view, several authors have varying arguments on different aspects of budgeting hence the objective of this analysis is demonstrating applicability of such views. To achieve the objective, the analysis uses Morrison's business and critically evaluates its budgeting process in reference to the views that tight budget times requires making decisions on priority basis. Further, there is a view that it is not suitable to base a budget on realistic assumption since it would result to funding reduction. Finally, the analysis evaluates refers to the view that a budget is not just a mere representation of figures but a reflect ion of values and inspirations.

Discussion

- Morrison's budgeting process

Morrison's at a glance

Morrison is the fourth largest food retailer in the UK with a turn over that exceeds £1. 6 Billion and having 439 stores across Britain. Its retail shops ranges between 8000 and 40000 square feet serving over 1. 1 million customers visiting the stores per week. The retailer has over 132, 000 employees. Although the business faced a difficult customer environment, the business has been experiencing an increase in number of customers to who it seeks to deliver value and quality. In that respect, Morrison's has a plan for expanding its operations to attract more customers hence a need for funding coupled with a tight budget that would require prioritizing the value growth projects for their immediate necessity in increasing value to customers. This also shows that the budget in this case would be a representation of the organizations aspirations to deliver value to its customers hence not just a budget of numbers. (Morrison, 2012)

Budgeting overview

A budget can be defined as an estimate that is expressed in monetary terms and prepared for a specific period in the future. In addition, the plan is approved prior to the future period and shows the expected income and/or expenditure as well as the necessary capital. In that respect, it can be defined by a number if essentials as follows

- It is prepared and approved in advance of the future period.
- It shows a plan for future actions which are quantified in monetary terms.
- Clearly defines the objectives to be achieved.
- Outlines the guidelines for achieving the objectives. (McClellan, Barr & Margaret, 2010)

Thus, a business has a number of budgets depending on the nature, conditions, capacity as well as periods for different business function. (Siegel, & Shim, 2008)

Morrison’s current budgeting process

Currently, the business uses the Incremental budgeting with its 2012 capital expenditure of £592 million having based on the 2011’s lower expenditure of £916 million. However, the business expects its investments to rise as they continue investing in its distribution channel development hence used the 2011 as the base year to review the need for further funding depending on the programs’ progress. In that respect, the objective of being able to deliver fresh and great foods at low prices through its operations that seeks to ensure that food products and services are delivered not only in its stores but also in entire supply chain led to a need for low cost operations/Cost control. This has been done through cost management strategies like buying directly from the customers as the business face a budgeting challenge in its bid to balance between a tight budget and daily life. (Morrison’s, 2012)

The organization’s budgeting follows a process as defined below

- Defining and setting goals as well as objectives to be achieved.
- Setting a plan for the future.
- Assessing resources allocation means.
- Uncovering potential challenges.
- Coordinating necessary activities.
- Communicating the plans. (McClellan et al, 2010)

Specifically, the business follows this process in the base year after which Incrimental Budgeting is applied. The budgeting is a tradational method that bases its planning and budgets on the previous year’s estimates adjusting them upward or downward depending on the current period’s consitions and assumptions. An increase in budget ammount is based on the expected increase in costs compared to the previous year's costs. However, the method fails to effectively evaluate the level of services and suitability of the programs in the current period. Those drawbacks are adressed through application of Zero Based Budgeting . (Fabozzi & Peterson, 2002)

Current budgeting translation to performance measures (KIP's)

Morrison's budgeting goes through a process that ends with the performance indicators that falls under several categories including input, output and efficiency indicators as follows.

- Input indicators

They involve the resources that the business uses in producing its output mainly comprising of staff hours and funds as well as other resources. Thus key input indicators include staff year equivalents, both budget and actual costs, full time equivalents as well as direct labor costs. However, the main indicator in this category is the direct costs like capital equipments, recovered costs/non pay expenditure, operating expenses and personnel services. (Fabozzi & Peterson, 2002)

- Output indicators

The indicators are a measure of what the business produced in its operations as well as the level of services it rendered in terms of volume of sales or services quality. Such indicators include the filling of the Human Resource vacancies and the number of customers served by the staff. (Siegel, & Shim, 2008)

- Efficiency indicators

They measure how suitable the output was given the level of input that the business applied with an example of the number of customers served by a single retail staff. Other perfect examples include the cost of each unit of services offered by the staff as well as the cost per vacancies that were filled by the Human Resources function. (McKinley, 2005)

- Recommendations

Application of Zero Based Budgeting

The business should adapt this method in order to address the challenges of Incremental budgeting. The Zero based budgeting process would follow the following process for every budgeting period.

- Management’s identification of activities that are then described as decision packages.
- Activities ranking in terms of benefits to the organization.
- Resources allocation in order of priority and spending level. (Fabozzi & Peterson, 2002)

This is a good alternative for Incremental Budgeting and does not base its planning on previous years’ figures rather bases its plan with Zero as its base hence making the budget a whole new plan for an organization. Zero Based Budgeting has an objective of resetting the budget for each budgeting period contrary to the Incremental Budgeting that assumes that the activities/operations have an allocation from the previous period hence the budgeting concern should only be the much by which it should be increased. Thus management should apply Zero Based planning to start the planning from the beginning assuming no spending base line from the past period.

The technique is useful in revaluation and examination of all operations and related expenditures for budgeting periods through an analysis of the workload involved as well as the alternative funding levels for each. The method seeks to justify each program before any allocation of funds and agrees with the view that estimates should be based on realistic estimates that are justified during the budgeting period to determine whether there is need for funding or not. In summary, the method follows the path of decision units' identification, decision package development to the ranking and review of the decision packages. In Morrison's the method's application could be reflected by the following

- Fresh consideration of all old and new budget items.
- Justification of funds to be allocated for the programs.
- The departments' objectives having a link with the corporate goals.
- The budgeting focuses on why the funds should be allocated rather than the amount to be allocated.

Participation of the organization's management at all levels which would enhance accountability. (McClellan, Barr & Margaret, 2010)

The method would help the business achieve effective resources allocation with all the programs' expenditures and funding being justified. In addition, the method would enhance a close examination of the cost behavior. However, the method has some disadvantages that include an increase in cost through an increase in paper work for each period's planning. In addition, the method faces challenges like the managers resistant to change as the method seeks to revaluate all operations and justify all expenditures.

Conflicts may arise in trying to properly rank decision packages and managers required extensive training on the concept as well as its application. Finally, there is a risk of an emphasis of short-term benefits at expense of long-term gains. (McClellan, Barr & Margaret, 2010)

Application of costing techniques

The business should also apply different costing techniques for different operations and activities in a bid to reduce its cost as well as non pay expenditure. Costing is done in a business applying several techniques depending on the type of activities and operations. Some of the costing methods applied by the firm include:

- Historical costing: Should be applied to ascertaining different period’s costs.

- Cost volume profit analysis: The method should be applied in analyzing cost behavior and pattern.
- Marginal costing: The process should involve segregation of costs in terms of fixed and variable cost. It is suitable in addressing short term goals as well as enhancing decision making in respect to the resources allocation.
- Budgetary control: Should be applied as a useful tool of planning and control among the different business functions.
- Standard costing and variance analysis: The method is useful in assessing the firms budgeting performance by analyzing the past estimates as well as the actual costs incurred during the current period.
- Absorption costing: Will be suitable in ensuring that all costs including fixed and variable ones are charged to the firm’s products. (McKinley, 2005)

Budget control/Measuring and controlling budget efficiency

In a bid to reduce non pay expenditures and measure the progress, control ratios application would be an effective control of the budgeted results where the ratios would be used to identify deviations of actual from the planned budgets. With the ratios being represented as a percentage, a ratio above 100% would show a favorable trend while a ratio of below 100% would be a reflection of unfavorable and adverse results. Further, the business should apply budgetary control which has the following objectives. (Bierman & Smidt, 2006)

- Basic purpose of planning and coordinating as well as controlling operations.
- Profit maximizing: It plans on how to maximize a business profits hence resources would be prioritized on profit maximizing programs.
- Control centralization: It seeks to centralize operations control enhancing delegation as well as responsibility.
- Resources optimization: Budgets seeks to optimize on resources in order to deliver more value and profitability hence support of the view that a budget is a representation of value and not a mere computation of figures.
- Coordination: It facilitates coordination among operation lines and activities including administration, production, purchase as well as selling and distribution.
- Cooperative spirit: Budgets enhances unification of management in seeking to achieve the common goals enhancing cooperative spirit within an organization. (Siegel, & Shim, 2008)

With the budgetary control in place, Morrison would have the control advantages including

- Control through making of corrections and providing the suitable remedial measures.
- Coordination among different functions is enhanced through the use of budgetary control helps
- Planning would be done with an objective of achieving maximum profits through resources and capital budgeting
- Evaluation would be done for all the operational areas with an aim of controlling cost to achieve profit maximizing through appropriate skills mix and outsourcing of some operations.
- Authority delegation would be done through a budgetary control system promoting responsibility and efficiency expenditure planning. (Willsmore, 2007)

However, the budgeting control applied would also experience new challenges including the conflict of goals as the method fail to consider the existing current environment. In addition, the process of beginning with estimates hence not would being accurate. Further, the changing economic conditions including inflation as well as government policies would make budgeting estimates less efficient in resources allocation hence the support of the view that budgets should not be based on realistic estimates because they could result ton reduced funding when conditions change. (Fabozzi & Peterson, 2002)

Establishment of suitable organization structure and budget centers

In order to enhance budgeting and address the issue of resources allocation, suitability of funding requests as well as the need for a budget to capture values and aspirations, Morrison's should seek to enhance its budgeting and budget control through developing a suitable organization structure that clearly sets out staff responsibilities. In addition, there should be an establishment of budget centers that will help in monitoring budget implementation and non pay expenditure. (Bierman & Smidt, 2006)

Conclusion

In light of the analysis, it has been demonstrated that budgeting is a dynamic process that changes with a change in conditions hence a need to adapt a budgeting method that suits a firm's operations as well as its objectives. In that respect, Morrison currently applies the traditional Incremental Budgeting and is a business that seeks to deliver value to its customers at low cost even when the market has a tight budget hence a need to prioritize resources allocation. Regarding the suitability of the current budgeting method, the organization should make several changes to its operations including adaption of an organization structure that enhances coordination between the management. In addition, the organization needs to establish budget centers that will enhance budget implementation as well as evaluation. Thus, the analysis concludes that priority basis is the key budgeting technique given tighter budgets, Further, the arguments are in agreement that a budget is a representation of values and inspirations and not mere figures as shown by the value that the business seeks to deliver to customers with its tight budget of low cost. Finally, the analysis has clearly supported the view that budgeting request based on realistic assumptions tend to get low funding.

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