BUDGETING PRACTICES IN MANUFACTURING FIRMS IN KENYA

Otieno Odhiambo Luther
Department Of Finance and Accounting,
University Of Nairobi,
P.O. Box 30197,
Nairobi 00100
Kenya
and
MAINA Judy Wangari

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Introduction

Globalization, intense competition, rapid advances in technology and shorter product life cycles have substantially transformed the environment in which businesses operate. Businesses must have excellent control over their costs to remain competitive (Banham, 2000; Johnston, 1990 and Kaplan, 1988). This requires that financial management systems, such as budgeting and standard cost management systems come under greater scrutiny.

Budgets are used in organizations for diverse purposes. They include, for example, performance measurement and evaluation, staff motivation, pricing decisions and cost control (Covaleski et al., 2003). An organization's objectives are expressed in time frames (three to five years) as informed by its mission and vision. Budgets come in after the strategic planning for the organization has been done, action planning has happened and the organization needs to know how much of resources will be required to execute those actions. The major value of budgeting lies in aligning the plans and budgets to strategies. The future of budgeting lies in planning for value.

Criticism of budgets is strong and persistence. budgets are time consuming and expensive, i.e. despite the advent of powerful computer networks and multi-layered models, budgeting remains protracted and expensive; budgets provide poor value to users; budgets fail to focus on shareholder value; budgets focus on internally negotiated

targets which tend to be incremental changes from the previous period's outcomes; budgets are too rigid and prevent fast response; budgets protect rather than reduce costs, “use it or lose it" is the manager's mantra; budgets stifle product and strategy innovation, "Never take risks." It is just not worth it; If it's not in the budget, you might be exposed; Budgets focus on sales targets rather than customer satisfaction; and that budgets lead to unethical behavior i.e. managing the results (also known as cooking the books) is a frequent outcome of budgeting. Many finance managers are well versed in "managing the slack" and feeding it into the results when needed (http://www.bbrt.org/bbconcept.htm, accessed 24th April 2008)

Research Question and Objective

There are two divergent views on the usefulness of budgets. Proponents of budgets argue that they are still relevant and useful while critics see budgets are obsolete. Blocher et al., (2002) argued that budgets help allocate resources, coordinate operations and provide a means of performance measurement. Hilton et al., (2000) agreed with this view and claimed that budgeting is the most widely used technique for planning and control purposes. Clarke and Toal (1999) too, were for the opinion that budgeting is essential. Traditional budgeting remains widespread, as many as 99% European companies have a budget in place and no mention of abandoning it (Dugdale et.al, 1999).

However, the information age is characterized by intense competition, uncertainty and a need to respond quickly to changes in the market. This implies that successful organizations are unlikely to succeed with the traditional command control culture. Budgets support a command and control culture. The use of a budget process results in the front line being disempowered because the front line must act within the constraints set by management rather than act upon the needs of customers and competitive threats. In managing performance, budgets represent fixed term performance contracts, a performance management system that does not help ensure the teamwork and agility required for organizational success (Fraser and Hope, 2003). The question then is: Should firms still use budgets?

The objective of this study is to establish the budgeting practices in manufacturing industries in Kenya and the reasons why budgets are used if at all. The practices surveyed will include the types of budgets prepared, the techniques adopted, the budgeting periods

and intervals, the factors considered while budgeting and the uses to which the budgets are put.

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Scope and Motivation for the Study

The study covers companies in the manufacturing sector. The Manufacturing sector is an important sector and covers firms that are engaged in the mechanical, physical, or chemical transformation of materials, substances, or components into new products, (North American Industry Classification System (NAICS) of 2007). The Kenya Association of Manufacturer's listing include: Food and Beverage Processing; Pharmaceutical and medical equipment; Wood products; Paper and Paper board; Leather products; Chemical and allied; Metal and allied; Textiles; Tobacco; and Plastics and rubber.

Kenya's manufacturing sector serve both the local market and exports to the East African region. The sector is dominated by subsidiaries of multi-national corporations. It contributed approximately 13% of the Gross Domestic Product (GDP) in 2004. The recent introduction of the EAC Customs Union provides Kenya's manufacturing sector, the most developed within the region, greater opportunity for growth by taking advantage of the enlarged market size, economies of scale, and increased intraregional trade (PwC). At the same time fuel cost and competition make manufacturing costly. In light of this, it is critical that players in the sector employ proper tools to plan for success and efficiency in their firms.

Literature Review

Budgeting in the private sector is a collective and closely coordinated exercise in which each activity is systematically related to the other. The company undertakes a thorough analysis of it previous experience, state of the economy, corporate objectives and available resources. Upon review of the budgets, if the CEO or the board finds the budgets unsatisfactory, they will ask the departmental heads to adjust in order to achieve a desired results (Biwott, 1998). Public organizations are more concerned with the

provision of public goods and their budget is mainly intended for authorizing actions and providing ceilings for management actions (Horngren, 1983).

Goldberger (1991) attempt address the reason why manufacturing enterprises bother about budgets, yet prices are determined by the markets, governments and the recovery of costs. Budgeting facilitates reliable and accurate measurement of performance besides aiding in cost control (Banham, 2000). In Kenya, Langat (2005) found that 18.8% of his respondents used the budgeted level as allocation base.

The process of budgeting force management to anticipate the obstacles and risks likely to arise in the course of achieving budgeted targets and is thus well-prepared to mitigate them. They are forced to plan ahead and systematically anticipate the future. Problems are anticipated and firefighting is reduced. Successful firms tend to be more proactive but less reactive in their operations.

Budgeting enables control of income and expenditure; it acts as a tool for monitoring and periodic evaluation of managerial policies and decisions; it facilitates optimal allocation of resources for maximization of profit and facilitates coordination and decentralization of tasks while still retaining control. Firms in the Export Processing Zone do not widely practice formal strategic planning. However, firms with more formal strategic planning have above industry average profits compared to those that do not. (Hapisu, 2003)

A budget helps identify weaknesses and deficiencies during the process of achieving targets; it gives a sense of direction to organizational activities and provides systematic and disciplined solutions to problems (Blocher et al., 2002; Browhill, 1987). Budgeting and budgetary control leads to the determination of investments required giving rise to finance needs. It is used internally to increase efficiency and externally for credit and security analysis (Mundu, 1997). This also gives the financial manager sufficient time to coordinate the collection of the necessary departmental information needed to develop the budget plan (Hofstede, 1991; Banham, 2000). For larger organizations this process could take three or four months or more to complete. In which case there is a need to look at the traditional role of budgets, the potential for improving the budgeting process, the radical alternative of doing without them and in that case the issues to be tackled beyond planning and control (Mourik, 2006).

Some researchers consider budgets a hindrance to modern organizations. “The budget is a relic from an earlier age, it is expensive, absorbs too much time and adds little value” comments Mitch Max of the specialist management consultancy, The Performax Group,

on a research briefing entitled "Slaying the dragon: Managing Performance Better Without Budgets".

The fundamental flaws inherent in the budgeting process are: cultural flaws – people ensure they set easily achievable targets and manage results closely to meet those targets to protect the future; strategic flaws – budgets are a barrier to change, even when planning horizons are shorter, as are product life cycles (Bowhill, 1987; Hofstede, 1991; Banham, 2000), assets are increasingly intangible and organizations are becoming more accountable to the customer (Bowhill, 1987, Hofstede, 1991), and (Banham, 2000); financial flaws – they are expensive, low value adding and are barriers to growth.

Budgeting helps estimate future events through forecasting. However, the future cannot be predicted with complete accuracy and therefore, budgeting is not precise; successful implementation of the budget implies cooperation and coordination between all managers, which may not always happen; the budget is merely a tool, which provides guidelines to, but cannot take the place of, management. It gives detailed information on how to achieve targets for the benefit of the business; management should avoid the mistake of putting too many expectations on the budget, since they all may not always be fulfilled (Banham, 2000; Blocher et al., 2002).

For budgetary control to be effective there needs to be a high degree of operational stability so that the budget is then valid for a reasonable period of time. For organizations operating in turbulent environments, budgetary control becomes less useful. Sometimes the focus is more on the expenditure in relation to budget as opposed to the project completion (Odundo, 2002).

Non-economic factors like politics and social orientation affect the budget process (Odundo, 2002). It is likely that a host of factors could affect the company's future and it could exploit this to its advantage, thus the need for a fact finding process during budgeting (Mbaru, 2005).

The development of an organizational budget requires input from a variety of inputs, including but not limited to upper management, customers, and historical cost data. As part of the service level agreement (SLA) negotiation process, prices must be established for all services provided. Inputs must be garnered from managers so that accurate prices can be negotiated. The financial manager should also examine trends from previous budget periods. Internal budgeting inputs and trends are used as inputs for the negotiation

process where final prices are set from which the budget is developed (Bowhill, 1987; Little et al., 2002; Banham, 2000).

One of the most important budget inputs is the service level agreement (SLA). Service level agreements answer the question: What have I promised to do? The matching cost data answers the other half of the question. How much does it cost to do what I have promised? Financial management provide input for the costs of services included in the SLA. In order to recover all operating costs from customers, the manager who negotiates an SLA agreement must have a complete understanding of the costs; and the process requires cost information from each manager. With this information, the financial manager can determine cost implication the SLA (Hofstede, 1991; Banham, 2000).

Accurate cost data provides a solid basis for negotiation. SLAs and historical cost data can provide parties to the negotiation with an accurate picture of what services were provided and at what cost. Without a complete understanding of the costs of providing services, managers are unable to negotiate agreements that are fair to each customer and still completely recover the costs of operating the environment. The negotiation process involves not only the negotiation of service levels, but also the setting of prices for the services provided, so that they can be appropriately budgeted for. Part of this activity involves the review of existing SLAs to verify that they are still needed and that the services being provided sufficiently meet customer demands (Banham, 2000).

As part of this evaluation, customers should be prepared to provide input regarding their strategies and goals for the upcoming year. Based on this information, SLAs are revised as needed to more accurately reflect the service requirements of each group. Only then can accurate prices be set for these services (Hofstede, 1991; Banham, 2000).

In addition to the negotiation of SLAs, each customer should provide information about future service requirements, thus providing input for the capital budget. For example, if an organizations accounting department is planning on purchasing software, i.e. an accounting package, the IT department may need to make modifications to existing system architecture (that is, new servers) to support the new software. Knowing this information well in advance gives the IT department time to plan for expenses related to system upgrades, service desk support, and so on (Clarke and Toal, 1999; Covaleski et al., 2003).

When setting customer service costs, the financial manager must gather budget inputs from each manager. Most of the budgetary inputs collected are the indirect costs of the

operating environment. For example, what training is required to teach personnel how to manage user accounts and security protocols? What training is required to inform the organization about policy changes, such as changes to the request for change submittal process? What costs are incurred for managing SLAs? Each of these costs must be identified and recovered (Covaleski et al., 2003).

Not all costs are known. In order to derive a complete budget unknown costs must be estimated. Unknown costs can be estimated using previous budget trends and by examining industry averages (Clarke and Toal, 1999). Trends are historical data of similar costs from previous periods that can be used to extrapolate costs for the current budget. When using trends to develop a budget, the financial manager must be careful not to underestimate the costs, which could lead to an insufficient amount of funds to operate the IT environment. However, it is equally unacceptable to overestimate costs, as these results in charging customers too much for the services being provided. In an organization that competes with vendors to provide services, overestimating costs can lead to the loss of service requests for each department (Covaleski et al., 2003; Little et al., 2002).

The budget process may begin with a copy of the previous budget. However some organizations practice zero based budgets. If a previous budget is the starting point then changes are made to the budgeted amounts based on the actual costs incurred to date. Each organizational department provides justification for increases from the prior year budget or actual incurred costs (Karmarkar et al., 1989; McNally, 2002).

Sometimes upper management provides direction to the budgeting process. This direction may come in the form of challenges or a percentage reduction. Where costs are charged back to internal customers, budgets may be dictated to be variable to base. If the business base decreases by 10 percent, the budget must decrease by a similar amount (McNally, 2002).

Zero-based budgets are built from the ground up, with all funds appropriately justified before they are included in the budget (Prendergast, 2000; Little et al., 2002; Pierce and O'Dea, 1998). The major advantage of this technique is that the budget developed is not simply a reworked version of the prior period's budget. All external support costs should also be assessed and their usefulness evaluated (Pierce and O'Dea, 1998). So, in essence, the budget planning process becomes a time to assess the operation environment and to evaluate where operational and financial improvements can be made (Prendergast, 2000).

Other methods include priority based budgeting which is a modification of the incremental budget to incorporate a sensitivity analysis e.g. what if funding increased by x%?, (Muleri, 2001). Different approaches to budgeting have been causes of great disagreements in the past as they directly affect accountability and subsequent performance (Amate, 1986).

Activity based Budgeting (ABB) is an approach to budgeting where the company uses the understanding of its activities and driver relationships to quantitatively estimate work load and resource requirements (Dierks and Cokins, 2000). The aim is to authorize the supply of only those resources that are needed to perform activities required to meet the budgeted production and sales volume. With ABB, cost objects are the starting point. Their budgeted output determines the necessary activities which are then used to estimate the resources required for the period.

The advocates of beyond budgets suggest that the budgets, as practiced in most corporations, should be abolished. That is a radical proposition, but it is merely a step in a long running battle to change organizations from centralized hierarchies towards devolved networks. Their argument is that most of the other building blocks are in place. Firms have invested huge sums in quality programs, IT networks, process reengineering, and a range of management tools including balanced scorecards, and activity accounting. But they are unable to realize the new ideas, because the budget, and the command and control culture it supports remains predominant (Fraser, Hope and Bunce**,** 2003**).** Beyond Budgeting (BB) is an alternative that is more adaptive and devolved. It replaces the budgeting model with a more adaptive and devolved alternative.

Criticizing budgets is not new. But to define a set of principles, that guides leaders towards a new management model, that is lean, adaptive and ethical. The approach has the benefits of; more innovative strategies, lower costs, more loyal customers and faster response. This is because the focus is on reducing complexity, clear governance principles and value to the customer. (Fraser, Hope and Bunce**,** 2003**)**

Beyond Budgeting is an attempt to combine the hard fact side in form of new performance management processes (typically the responsibility of finance) with the soft fact side of a new performance management climate and a "devolutionary framework", where the people at the front, working with customers, get the freedom to decide and act (typically the responsibility of the CEO and of HR). This requires the commitment of the executive team, but the contribution of especially three corporate functions: finance (hard

facts); IT (bringing the hard facts to everyone) and HR (managing the change from a people perspective) (www.juergendaum.com, accessed 24th April 2008)

Does a relationship exist between Budgeting and Performance?What does the theory tell us? In their review of world wide budget practices, a team from the centre of business performance at Cranfield School of Management did several case studies on the effect of budgeting on financial performance. They found that most of the companies studied did not use the approaches suggested in their pure form but used customized approaches. The analysts (96%) said that forecast accuracy and management credibility influence market expectations; while 85% of them stated that they believe that budgeting systems have either a direct or indirect impact on profits and hence on share valuations.

The relationship between strategic variability and planning comprehensiveness is limited. However, for strategic planning to be effective certain preconditions must exist, e.g. sound financial reporting systems must be in place, (Piest, 1994). McKernan and Morris argue that there is a consensus that formal strategic planning facilitates survival especially in turbulent environments.

Previous studies which have examined the relationship between planning and business performance have reported mixed results. Some found positive and significant impact while others found no relationship. Some studies have concluded that SME's engaged in strategic planning are more likely to utilize formal capital budgeting techniques including the net present value method which is consistent with maximizing the firm value. Financial planning and control leads to determination of investments required thus giving rise to finance needs (Mundu, 1997).

Research Methodology

This is a survey of budgeting practices in manufacturing firms in Kenya in order to establish the budgeting practices used in the manufacturing industry in Kenya. The practices include: techniques, methods, uses, perceived limitations and factors considered while budgeting. The target population is manufacturing firms in Kenya. A sampling frame is created using the Kenya Association of Manufacturers members register obtained from their website as accessed on 11th March 2008. The total number of members in the register is 549. Of these, 412 are in Nairobi and 334 are in the manufacturing sector. Nairobi was chosen due to the geographical convenience to the researcher, cost of collecting data as well as the time that would be required if the data

were to be collected outside Nairobi. This was still be fairly representative given that over 75% of the KAM members are in this region. The KAM listing was used as the basis because it was the most organized. The implication is that only manufacturers who are registered as members will be studied.

Since the population embraces 10 distinct categories, the frame will be organized by the above categories into separate "strata." A sample will be selected from each "stratum" separately, producing a stratified sample. The two main reasons for using the stratified sampling design are; to ensure that all categories are adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.

The sample size will be determined using the "Creative Research Systems" sample size calculator. (http://www.surveysystem.com, accessed 9th May 2008) To achieve a confidence level of 95%, a sample size of 75 will be used. The proportion of the stratum size to population size will be used to determine the spread of the sample across strata.

Given that this is more than 5% of the total population studied, the sample size can be reduced without sacrificing precision (Cooper, Schindler, 2003). This will give me some space in case some of the questionnaires do not get returned.

A semi-structured questionnaire is administered to manufacturing firms within Nairobi and its environs. This method has been chosen as it is the most feasible way of reaching this number of respondents. The drop and pick method has been chosen because the questions are simplified and unambiguous making it easy for the respondent to answer on his own.

The first set of questions, (Section A) is general in nature and will be used to gather some basic information about the firm. This will be useful in categorizing the firm as either large or small. The second section (B) seeks to address the objective of establishing the budgeting practices in use in the manufacturing sector. Respondents are asked specific questions regarding the types of budgets they prepare, the time range covered by the budgets, uses to which budgets are put and factors considered while budgeting.

The questionnaire combines two types of questions. One has questions whose response will be either yes or no while the other has a numbered scale where individuals will be required to make a decision on their level of agreement, generally on a five-point scale (i.e. Strongly Agree, Agree, Undecided, Disagree, Strongly Disagree) with each

statement. The number beside each response becomes the value for that response and the total score is obtained by adding the values for each response.

Field editing was minimal since the questionnaire was dropped for the respondent to complete. The questionnaire is analyzed centrally for accuracy and completeness. The data then checked for any errors and omissions (Kothari, 1990). Coding of the responses is performed to facilitate statistical analysis. Firms are classified into: Small: - covering small and medium enterprises with upto 100 employees and Large: - Covering large firms with over 100 employees.

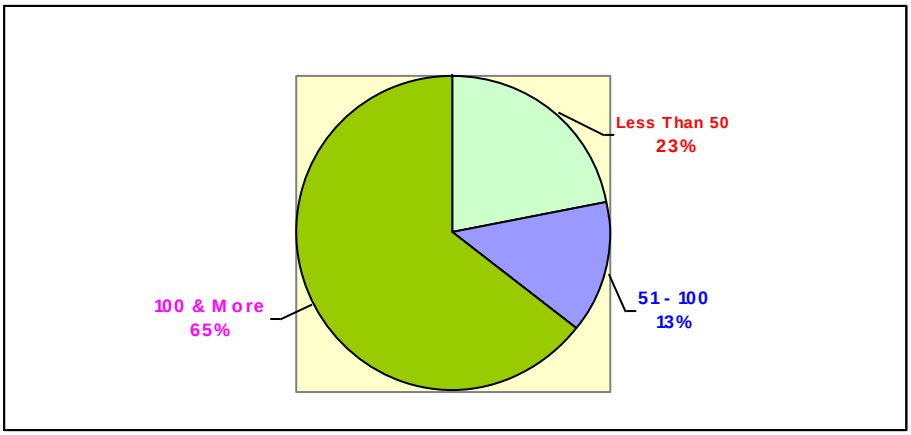
The budget types and techniques are addressed by the first group of structured questions with a "yes or no" response. For the semi-structured questions e.g. the time range, basis of breakdown the responses are presented in the frequency. In addition, measures of central tendency will be used especially the mode to determine the techniques used by most companies.

In analyzing the data on aspects of budget implementation, challenges, perceived importance of the budgets and factors considered while budgeting, responses on the Likert scale is collated using frequency tables. The the median and the mean will be used to analyze the responses. To measure the level of consensus regarding a variable, measures of dispersion will be employed mainly the standard deviation.

Data Presentation, Analysis and Interpretation

Data was collected from 45 firms in the manufacturing industry. Of the 75 targeted firms, 45 of them responded representing 60% response rate. The number of firms that prepare budgets from the sample represents 98% of the firms studied, while only 2% do not prepare any budgets**.** Twenty nine (29) of the 45 firms, i.e. 65 percent of the respondents have more than 50 employees and can therefore be classified as large manufacturing firms. (See Fig 1 below)

Fig. 1 Categorisation of firms by Number of Employees



Source: Research Data

All the firms studied indicated that they were engaged in the conversion of materials into finished product (see table 1 below). The responses were distributed as follows across the industries:

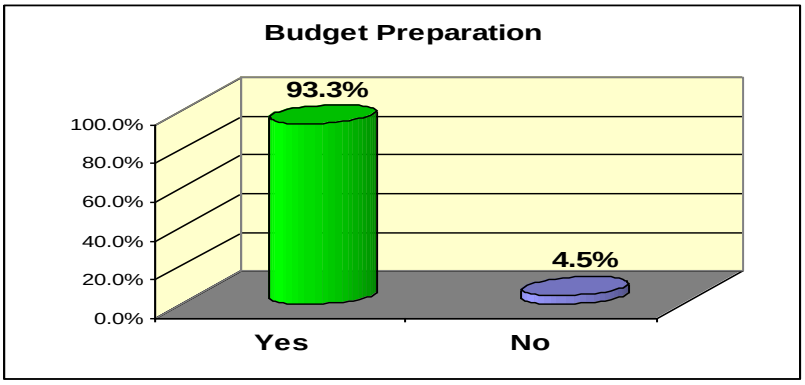
Table 1 Distribution of respondents

Category	**Responses**
Food, Beverage and Tobacco	12
Chemical and Allied	5
Leather Products and Footwear	0
Metal and Allied	5
Motor vehicle assembly	1
Paper and Paperboard	4
Pharmaceutical and Medical Equipment	4
Plastics and Rubber	6
Textile and Apparels	6
Timber, Wood and Furniture	2
Total	**45**

Source: Research Data

A clear majority indicated that they do prepare budgets. Only 2 firms responded that they do not prepare budgets. As such, 43 firms (93.3%) do prepare some type of budgets, see fig 2 below.

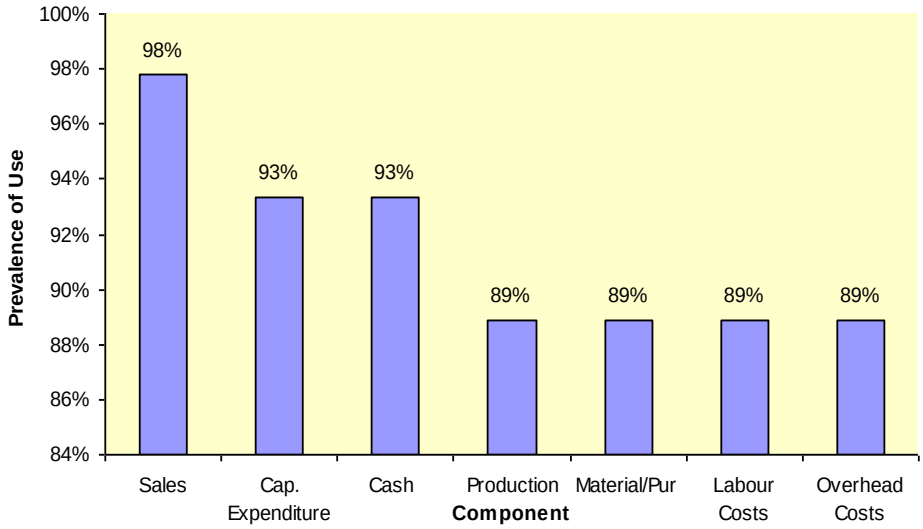
Fig. 2 Existence of Budgets



Source: Research Data

Majority of the firms studied prepare all the components of the operating budget. They prepare production budgets, sales budgets, Capital expenditure budgets and overhead cost budgets. Of all the components, sales budgets were the most widely prepared with 98% of the firms preparing them. Figure 3 summarises the prevalence of the components of the operating budget.

Fig. 3 Components of the Operating Budget



Source: Research Data

When the respondents were asked about the budgeting methods that their companies have adopted, a majority of them used prior year budgeting. More than half of the firms (59.1%) have adopted prior year budgeting, while the rest use zero based, activity based or a combination of all the three. A majority of firms (76%) prepare budgets that cover between 1 and 3 years. The performance against budgets is reviewed on a monthly basis

by 77% of all the firms while 73% of the firms studied break down their budgets on the basis of time and department.

The responses around the specified aspects of budgeting indicated that majority of the firms have faith in the budgeting process. They indicated that that there is good information flow during budgeting and that budgets are widely accepted within the organisations.

Table 2 Aspects of Budget Implementation

Aspects of Budget Implementation	**Strongly Disagree**	**Disagree**	**Not Sure**	**Agree**	**Strongly Agree**	**Total**
Good Information Flow	2	4	4	16	18	44
Budget Accepted with Reception	2	12	4	8	16	42
Effective Leadership Provided	8	8	2	10	16	44
Effective Coordination	6	2	2	18	16	44
Total Score	**18**	**26**	**12**	**52**	**66**	**174**
%	**10%**	**15%**	**7%**	**30%**	**38%**	**100%**

Source: Research Data

A majority of the firms do not identify with the criticisms of budgeting. When asked to rate their agreement or otherwise to the criticisms of budgeting that are the basis of "beyond budgeting", majority either disagreed or strongly disagreed with the criticism posed. The one criticism that the respondents agreed with somewhat was that budgeting stifles innovation. This scored a mean that is barely above the median score of "not sure". All other factors were generally disagreed with and scored below the median.

There was consensus among the respondents that budgets do add value and are focused on the overall strategy of the firm. The standard deviations for the two variables were 0.98 and 0.88 respectively, suggesting high level of agreement amongst respondets.

As regards whether budgets are focused on value in the eyes of the customer, there was high variability (standard deviation of 1.62) meaning that some respondents felt that budgets are focused on the customer while others felt differently.

The responses of various company representatives are shown in table 4.3 below.

Table 3 Criticisms of Budgeting

	Variables						
	Time	**NVA**	**Focus**	**Strategy**	**Inflexible**	**Customer**	**Innovation**
Total Score	94	62	63	87	94	98	133
Mean	2.19	1.44	1.47	2.02	2.19	2.28	3.09
Standard Deviation	1.38	0.98	0.88	1.42	1.01	1.62	1.41

Source: Research Data

This may be an indication that "Beyond Budgeting" is still a long way off in our emerging economy and that budgeting in its current state is widely accepted in the local manufacturing industry. Manufacturers do not agree with the criticisms that have been forwarded as a basis for the beyond budgeting model.

Table 4 Criticism of Budgeting Ranking

	Disagree	Agree	Not Sure
Do not Add Value	86%	9%	5%
No Focus on Shareholders' Value	82%	5%	13%
Divorced From Strategy	82%	18%	0%
Time Consuming/Expensive	77%	23%	0%
No Focus on Customer Satisfaction	68%	32%	0%
Rigid & Inflexible	64%	18%	8%
Stifle Innovation	52%	29%	19%

Source: Research Data

The respondents were asked why in their opinion the targets set during budgeting are sometimes not met. From those who responded, 55% agreed that Companies fail to meet their targets because they set unattainable goals, but 73% felt that the uncertainty in the environment leads to non achievement of goals. This is illustrated in the table 5 below:

Table 5 Challenges of Budgeting

Challenges	**Disagree**	**Agree**	**Not Sure**
Departmental Inability	68%	32%	0%
Unattainable Standards	45%	55%	0%
Uncertainty	27%	73%	0%
Ineffective Planning	36%	50%	14%

The respondents were asked to indicate on a scale their agreement or otherwise the extents to which budgets are used for particular purposes in their organisations. The results indicated that budgets are put to various uses. Most of the firms do not use budgets as a means to calculate rewards or to motivate employees. The respondents rated profit maximisation as the most important use to which budgets are put and motivation of employees as the least important use of budgets. The variables studied were; forecasting the future (FC), Profit maximization (PM_1), communicating the company's objectives (Comm.), Performance measurement (PM_2), means of calculating rewards (Rew), Motivation tool (Mot), control tool (cont), Funds allocation (FA), Calculating cost of goods (COGS), reduce risk of failure (RR) , reduce costs (CC) and Investment Appraisal (IA).

The most important use according to this research is funds allocation with a mean score of 4.28 followed by profit maximisation with a mean of 4.23. Calculating rewards and motivation staff was rated as the least important. The mean scores (2.86 and 2.88 respectively) were below the median score of 3 indicating that factors are not considered important uses of budgets.

Funds allocation and profit maximisation are uses that show the lowest distance form the mean. The standard deviation is the lowest at 0.85 and 1.09 respectively followed by forecasting the future at 1.25. The highest variability is seen in use of budgets as means for reward calculation with a standard deviation of 1.63.These measures are in the table 6 below:

Table 6 : Uses of Budgets

Variables	FC	PM_1	Comm.	PM_2	Rew	Mot	Cont	FA	COGS	RR	CC
Total Score	179	182	158	140	123	124	169	184	125	154	143
Mean	4.16	4.23	3.67	3.26	2.86	2.88	3.93	4.28	2.91	3.58	3.33
Std Dev	1.25	1.09	1.46	1.45	1.63	1.52	1.35	0.85	1.59	1.37	1.46

Different factors were posed to the respondents who were asked to rate their importance to the budgeting process. The factors posed to them were; economic outlook, past behaviours and emerging trends, government regulations and controls, consumer attitudes, tastes and preferences, competition, advertising efforts and political situation. In addition to the factors specified, firms indicated that they do consider their production capacity, availability of funds, new products and services as important factors to consider while budgeting. Firms indicated that economic trends and outlook are the most important factor with a mean score of 4.58 in a rating scale of 1 to 5. The next was trends and behaviours of past costs followed by competition with means of 4.44 and 4.30 respectively. The factor considered least important was the Advertising and Promotion efforts of the firm with a mean of 3.23. All the factors were rated above the median of 3. The greatest consensus is found in importance of economic outlook with a standard deviation of 0.85. The importance of consumer attitudes and preferences shows high variability with a standard deviation of 1.55

Table 7 Factors Considered When Budgeting

Variables	Economic outlook	Past Trends	Govt Regulations	ADTP	Competition	A&P	Political Political
Total Score	197	191	174	147	185	139	151
Mean	4.58	4.44	4.05	3.42	4.3	3.23	3.51
Std Deviation	0.85	1.05	1.36	1.55	1.04	1.56	1.3

Source: Research Data

Summary of findings

The results indicated that 93.3% of the firms prepare budgets. The components of the operating budget is widely prepared with 98% of the firms preparing the sales budget and 89% of the firms preparing the production, material and purchase, labour costs and

overhead cost budgets. Cash budgets and Capital expenditure budgets are prepared by 93 % of the firms.

The most widely used method of budgeting is the prior year (incremental) method used by 59.1% of the firms and performance against budgets is reviewed monthly by most of the firms.

Economic outlook, competition and trends of past costs are considered the most important factors to consider while budgeting with mean ratings of 4.58, 4.44 and 4.30 against a median of 3 in a scale of one to five.

Most firms do not agree with the criticisms of budgeting posed by the proponents of "beyond budgeting". In a scale of 1-5, all variables posed scored a mean that was below the median. The criticism that budgets stifle innovation scored slightly above 3 at 3.09 indicating some agreement with this criticism.

Profit maximization, forecasting the future and funds allocation were rated the most important uses of budgeting with mean ratings of 4.23, 4.16 and 4.28 respectively.

Conclusions

The objective of this study was to establish the budgeting practices in manufacturing industries in Kenya and the reasons why budgets are used if at all. Ninety three (93.3%) of the respondents indicated that they use budgets. We can therefore conclude that budgeting is a widely used practice. The results indicated that of those that prepare budgets, all of them use at least one component of the operating budget. A clear majority use most of the components of the master budget i.e. the operating budget is a widely used tool in the manufacturing industry. Cash budgets and capital expenditure budgets are also common.

The most widely applied budgeting period is between one and three years and most of the firms review performance against budget every month. It is obvious that budgeting is used by the manufacturing firms as a management tool for evaluating performance of the firm. It is also clear that the companies' medium term strategic plans are expressed in budgetary terms.

The most important use of budgets according to this research is maximisation of shareholders value. This is achieved through planning for the most optimal use of resources as well as continuously evaluating performance and putting in corrective action

in good time. With most of the firms reviewing their performance against budget every month, deviation form planned performance will be realised and corrected in good time.

The most important factor to consider while budgeting is the overall economic outlook. With all factors getting a mean that is above the median of 3, we can conclude that all of them are considered important to the process. This is in line with the review of literature which indicated that unknown costs can be estimated by use of past trends and industry averages. (Clarke and Toal, 1999).

Also rated important are government regulations and controls and the competition. This aspect is agreement with the indication that in an organization that competes with other vendors to provide services, overestimating costs can lead to the loss of service requests for each department (Covaleski et al., 2003; Little et al., 2002) These are assumptions which if inaccurately estimated can render the budgets irrelevant.

The least important factor is firms own advertising and promotion efforts and there is no consensus on the importance of this factor. Some of the respondents consider it important while others do not. We can only speculate that the importance or otherwise may depend on other factors like the category of manufacturing that a firm belongs. This was not tested in the research and would be a good basis for further research in this area.

In as far as challenges that lead to the budgeted output not being achieved, uncertainty in the economic, political and technological environment was ranked the most important reason. This is hard to predict and when the actual turns out to be different from the assumptions, then the performance is likely to be very different from the budgeted performance.

With regard to the criticisms of budgeting which form the basis of the "Beyond Budgeting" most firms did not identify with the criticisms highlighted in section 2.4.2 of this paper. They largely disagreed with all the criticisms of budgeting. All but one of the factors had a mean rating that was below the median. This indicates that budgeting in its current form is widely accepted in the manufacturing industry and will be around for sometime. Overall, they strongly felt that budgets do add value and that they are aligned to strategy and value in the eyes of the shareholder.

The Manufacturing industry should adopt more advanced methods of budgeting. Majority of them (59.1%) use the more traditional prior year budgeting method. Although historical data cannot and should not be ignored while planning for the future, prior year budgeting has some significant shortcomings which could compromise the value of the budgets prepared. The problem is that less thought goes into the process and real change is not catered for.

Zero based budgets better equip management to make decisions when comparing actual program performance to the budget. Zero-based budgeting most often gives a better estimate of income projections and helps create a model for spending by breaking the habit of budgeting nonessential costs simply because they were incurred the prior year.

Since Zero Based Budgets and Activity Based Budgeting have their own shortcomings, the companies may benefit more from using a hybrid of all the methods. Some costs may only be reasonably estimated using historical data. However, incremental (prior year) budgeting in its pure form may lead to carrying forward of inefficiencies from previous years.

With regard to review of the budgets, a majority of the firms indicated that performance against budgets is reviewed by top management. While this is good, ways should be devised of incorporating cross functional teams that cut across all ranks to create a sense of financial ownership within the organizations. This way, implementation of the corrective actions will seem less of an imposition.

Although calculating rewards and measuring performance of employees were rated as the less important uses of budgets, an ambitious and exhaustive budget can be used as a means of calculating rewards. This way, the employee is able to see what is in it for him and works hard towards achievement of that budget.

With regard to criticisms posed by the proponents of beyond budgeting, there is wide disagreement with all the factors by majority of the firms studied. Budgeting is widely accepted in its current form in the manufacturing industry in Kenya. Although budgeting is a useful tool, there is need to adopt more recent developments or at least borrow from them. These include “beyond budgeting” and “benchmarking”. These recent approaches to budgeting focus on the entire performance management process and are in favor of

more flexible models by which managers are able to regulate their own performance, and financial planning processes and individual behavior are therefore better aligned with corporate strategy.

Budgets are useful as a management tool but need to be used with caution. Sometimes there is temptation to be too prudent and set very lenient budgets. This ensures that performance is always exceeding targets but value for the shareholder remains less than optimal.

This study was limited by the fact that some respondents deemed the information required as confidential. As such, some questions were left unanswered and some did not fill the questionnaire at all.

The questionnaire was administered on a drop and pick method. This proved to be limiting when certain responses provoked a further exploratory question which was then not asked since it was not a face to face interview. For instance where a respondent said that their organisation did not prepare budgets, it would have been of value to inquire why this is so or what tools they use in the place of budgets. This would only be possible in a face to face interview.

Budgeting should be studied in other sectors of the economy like the agricultural sector. Agriculture is a main source of livelihood for many Kenyans and strategic planning in the sector could play a big role in the success of the sector.

More recent developments like “beyond budgeting” need to be studied in the manufacturing sector to assess whether the criticisms of budgeting have been felt and addressed. Further research may be done to assess the relationship if any of the budgeting practices to the performance of the companies.

For the factors that affect budgets which the respondents indicated to be important to the process, it will be worthwhile to study them in depth and establish the extent to which they affect the process. Such research would aim to study how the firms go about estimating these factors to enable them make realistic assumptions.

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