



UNIVERSITY OF NAIROBI

SEED ENTERPRISE MANAGEMENT INSTITUTE (SEMIs) SHORT COURSES

2015 SERIES OF LECTURES, PRACTICALS AND FIELD TOURS

1. Seed Production
2. Seed Drying, Processing and Storage
3. Seed Business
4. Seed Marketing
5. National Plant Protection Organizations (NPPOs) and Seed Quality Regulators
6. Seed Production Field Diagnostics
7. Seed Quality Assurance and Seed Quality Management

Compiled By:

Mwang'ombe, A. W., Olubayo, F. M., Njoroge, K., Wasonga, D., Abook, B., Miringu, T. K., Kiwunja, F. and Amateshe, L.

SEMIs, Department of Plant Science and Crop Protection

Email: info@semis-africa.org

Telephone: +254 20 35927361, +254 722382300

Acknowledgements:

School of Business, University of Nairobi

Seed Centre, Iowa State University

CYMMIT, Zimbabwe

International Consultants – Aline, F. O'Connor, Dilip Gokhale

KALRO

KEPHIS

Seed Companies: Kenya Seed, Leldet, Drylands Seed

University of Nairobi Library – Mugo, H. and Mioru, G.

SEED ENTERPRISE MANAGEMENT INSTITUTE (SEMIS)

OVERVIEW OF SEMIS TRAINING MODULES

Mwang'ombe, A. W., Olubayo, F. M., Njoroge, K.



IOWA STATE UNIVERSITY



Project Implementation

Alliance for a Green Revolution in Africa-AGRA

Total funding:4,495,432.00 USD

Phase 1: 3 years (2010-2013),Phase 2-2014-2016

Institutions

University of Nairobi

PI: Prof. A.W. Mwang'ombe

Management: Prof. F. Olubayo, Prof. Kiarie Njoroge

Daniel Wasonga –Project Manager, Florence Kiwunja-Admin. Asst.,

Francis Maina, Caroline Ndumi, B. Kirangu -Field Assts

CIMMYT:

Dr. John
MacRobert
(Author-Seed
Business Mgt In
Africa)

KEPHIS:

DR. Esther
Kimani-
Director
KEPHIS
Mr. Kibet

KARI:

Dr. Riungu
and Dr.
Ragwa

Consultants

Aline O'Connor
Funk
Paul Seaward
Paul Okete

ISU

Dr. Misra
Dr. Y. Shyy
Dr. Joe Cortes
Dr. Mike Stahr

SEED ENTERPRISE MANAGEMENT INSTITUTE (SEMIs)

Overall Goal

- Eradication of food and nutrition insecurity through capacity building of seed actors .
 - quality seed
 - affordable seed

Objectives:

1. To produce seed production and marketing management expertise in SSA region
2. To train seed industry practitioners on the best practices to efficiently produce adequate high quality seed for farmers.



3.To enhance production of seed of improved varieties for the SSA

- Efficient production
- Marketing
- Good distribution

4. To strengthen the capacity of the SSA region to train on seed production and marketing management strategies

- Enhanced technology

5.To develop a regional capacity to facilitate information sharing on seed issues and related disciplines in SSA.

Growing the Seed Industry in Africa

SEMI's PARTNERSHIPS



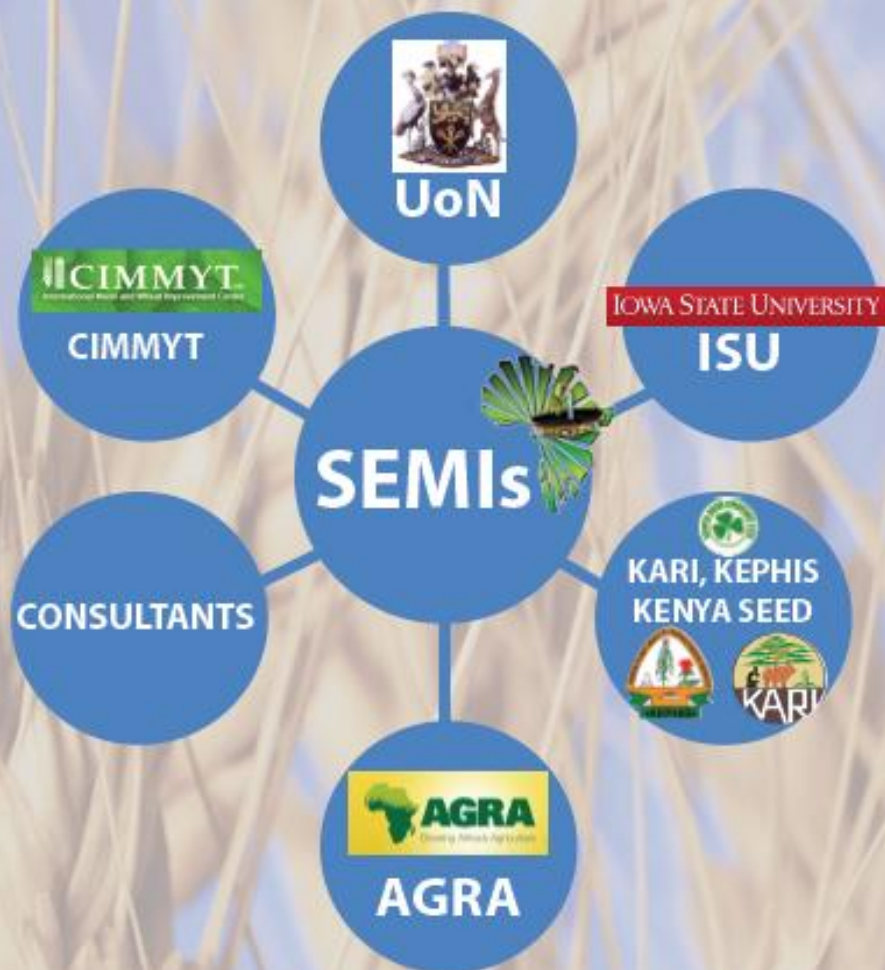
agra-alliance.org



cimmyt.org



kephis.org



uonbi.ac.ke



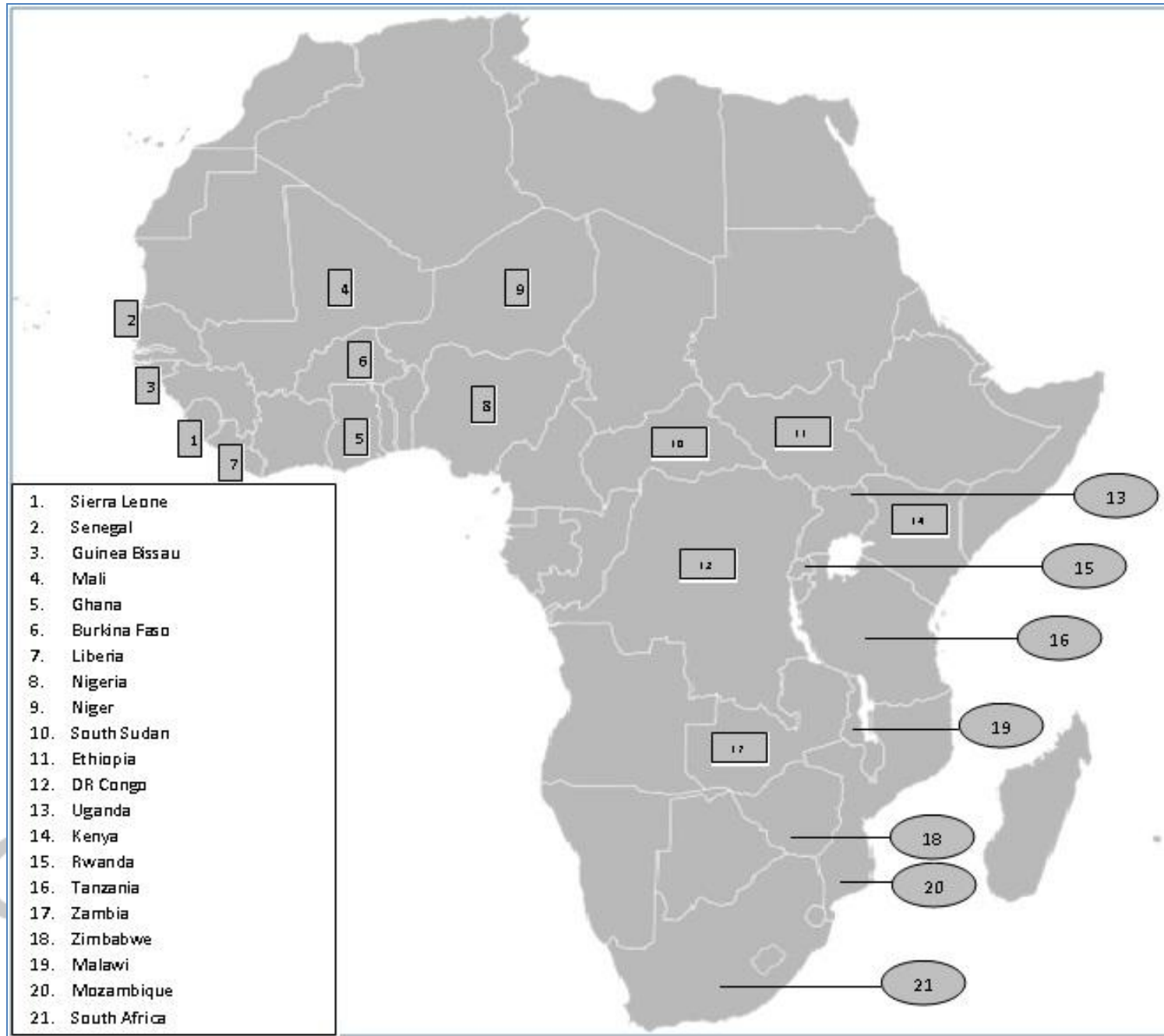
iastate.edu



kenyaseed.com

GROWING THE SEED INDUSTRY IN AFRICA

SEMIs in 21 African Countries!!!





SEMIs COURSES AT UON:



Course	Collaborators	Coordinators
Seed production	UoN, CIMMYT, KEPHIS, KALRO, Leldet seed co.	Prof. Kiarie Njoroge/ Prof. Olubayo
Seed drying processing and storage	UoN, ISU, KEPHIS, KALRO, Kenya seed Co.	Dr. Onyango Mbunge, Prof. Kiarie Njoroge, Prof. Olubayo
Seed marketing	UoN (sch of Bus), Aline O'Connor, Kenya seed Co.	Dr. Justus Munyoki, Prof. Kiarie ,
Seed Business Mgt.	UoN (Sch. Of Bus.) Aline O'Connor, Kenya seed Co.	Prof. Evans Aosa, Prof. Olubayo, Mr. Herick ondingo
Seed Quality assurance and Seed Enterprise Quality Management	UoN, ISU, KEPHIS, KALRO, Kenya Seed Co.	Prof. Olubayo, Prof. Muthomi, Prof. RD. Narla,
Seed Production Field Diagnostics	UoN, KEPHIS, KALRO, Kenya Seed Co.	Prof. Olubayo, Prof. Muthomi/Prof. Narla/Prof Mwang'ombe
National Plant Protection Organizations (NPPO)	UoN, KEPHIS, KALRO, Kenya Seed Co.	Prof. Kiarie, Prof. Olubayo

SUMMARY OF TRAINED PERSONNEL IN PHASE I – 2010-2013

Course	2010	2011	2012	2013	Total Per Course
Seed Production	29	27	30	0	86
Seed Drying Processing and Storage	31	28	30	0	89
Seed Business Management	29	26	29	25	109
Seed Marketing	28	25	30	27	110
Seed Quality Assurance	30				30
Seed Legislation and Accreditation	25				25
Seed Quality Assurance and seed Enterprise Quality Management		26	29	0	55
Total(Yearly)	172	132	148	52	504

SUMMARY OF TRAINED PERSONNEL IN PHASE II – 2014-2016

Course	2014	2015
Seed Production	23	26
Seed Drying Processing and Storage	23	25
Seed Business Management	19	30
Seed Marketing	20	31
Seed Quality Assurance and seed Enterprise Quality Management	19	30
National Plant Protection Organizations and Seed Quality Regulators	21	24
Seed Production Field Diagnostics	18	24
Total(Yearly)	143	190



Seed processing and drying



Seed production



Seed Marketing

Long Term courses in Seed Technology and Business:

Curriculum already in place for:

- I. Certificate-Seed Technology and Business
- II. Diploma -Seed Technology and Business
- III. Post-graduate Diploma-Seed Technology and Business
- IV. MSc.-Seed Technology and Business

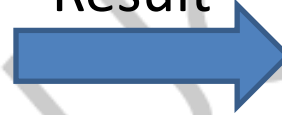


15 Students have enrolled for the MSc. Seed Technology and Business program

SEMI's Curricula

- Involvement of stakeholders in the development;
- ISU, Consultants, CIMMYT, UON, KARI, Seed Companies
- Annual Review every year to keep abreast on seed Issues and changing trends in the seed industry

Result



One of the best “thought-through” and relevant curricula in Africa focused on seed



World Class Facilitators:



John MacRobert-
CIMMYT



Kiarie Njoroge-UON CAVS



Jenny Leakey-Leldet



Dr. Yuan Shyy-ISU



Aline O'Connor –Seed
Business mgt



Dr. Joe Cortes-ISU



KEPHIS

TRAINED PERSONNEL ARE A GREAT ASSET FOR SEED COMPANIES:

The training at SEMIs is helping Scaling up production of high quality seed for farmers around Africa



Dry Land Seed co.

So far over 100 seed companies from 21 African Countries have benefited from training at SEMIs

Other Activities at SEMIs:

Foundation seed production at CAVS:

Varieties:

- Meizi mbili
- Kenya Wonder
- Kenya Red Kidney
- Kabete Super
- Kenya Sugar Bean
- Super Rosecocco



Provision of foundation seed for seed co.

White label seed produced at SEMIs

Year	Tonnage	Variety
2013	1.76 tonnes	Kenya Red Kidney, Meizi Mbili
2014	4.3 tonnes	Kenya Red Kidney, Kabete Super, Miezi Mbili



“Seed companies all over Africa indicate foundation seed availability and access as a major contributor to low seed production”

Presentation of White label breeder seed to Kenya seed company CEO. Mr. Soi at a ceremony at CAVS

SEMI's INFRASTRUCTURE DVPT

Modern Seed laboratory and Seed Processing facility being constructed at CAVS with SEMI's funds

Phase 1: Seed Processing Unit.

- Seed from UNISEED and other seed companies to be processed

Phase 2: Modern Seed Laboratory for Seed Quality Assurance

- Seed Quality Laboratory



Phase 1: Seed Processing Unit

Construction of Seed processing factory is complete. The factory to process over 5000 MT of seed



- Installation of seed processing machines ongoing.
- Expected handover date- Early August 2015





PHASE II: LABORATORY CONSTRUCTION

- Construction of seed laboratories is ongoing- 90% is complete
- Painting works and fittings ongoing with expected handover – End September, 2015



Participation in National and Regional Workshops and Meetings on Seed Issues



Agricultural Sector Development forum- Kibaki in attendance



Kenya-Agricultural transformation Day in Nairobi

Other meetings	Year
FARA Meeting	2011
KARI congress	2012
STAK congress	2013
ASK Show	2014



H.E. Mohamed Shein Pres. Of Zanzibar at the AFSTA-Congress Zanzibar

SEMIs at the ASK show in Nairobi



Rosebenna from SEMIs talks to farmers on the New Bean Varieties

SEMI is a point of call for seed companies:



- Agricultural /Seed Institutions are using SEMI as a port of call during meetings and visits

- Point of reference for seed trends.

- Need to platform this to become the leading seed reference point in Africa

Seed company personnel with STAK officials call in at SEMI

Highlights ..



Experiential training-Visit to the seed industry



Training on Finance and capital Acquisition:
-Root capital and ASIF funding
Experts at SEMIs

Collaboration with Stakeholders and Experts:



Dr. Julius Kipng'etich-Director, Kenya Wildlife Services (KWS)

Guest lecture at the seed business module course

Observed Changing trends in the Seed Industry in Africa.....

“as I move across Africa, I see African Farmers have changed their strategy to improved seed”

Dr. Joe DeVries-Director, PASS



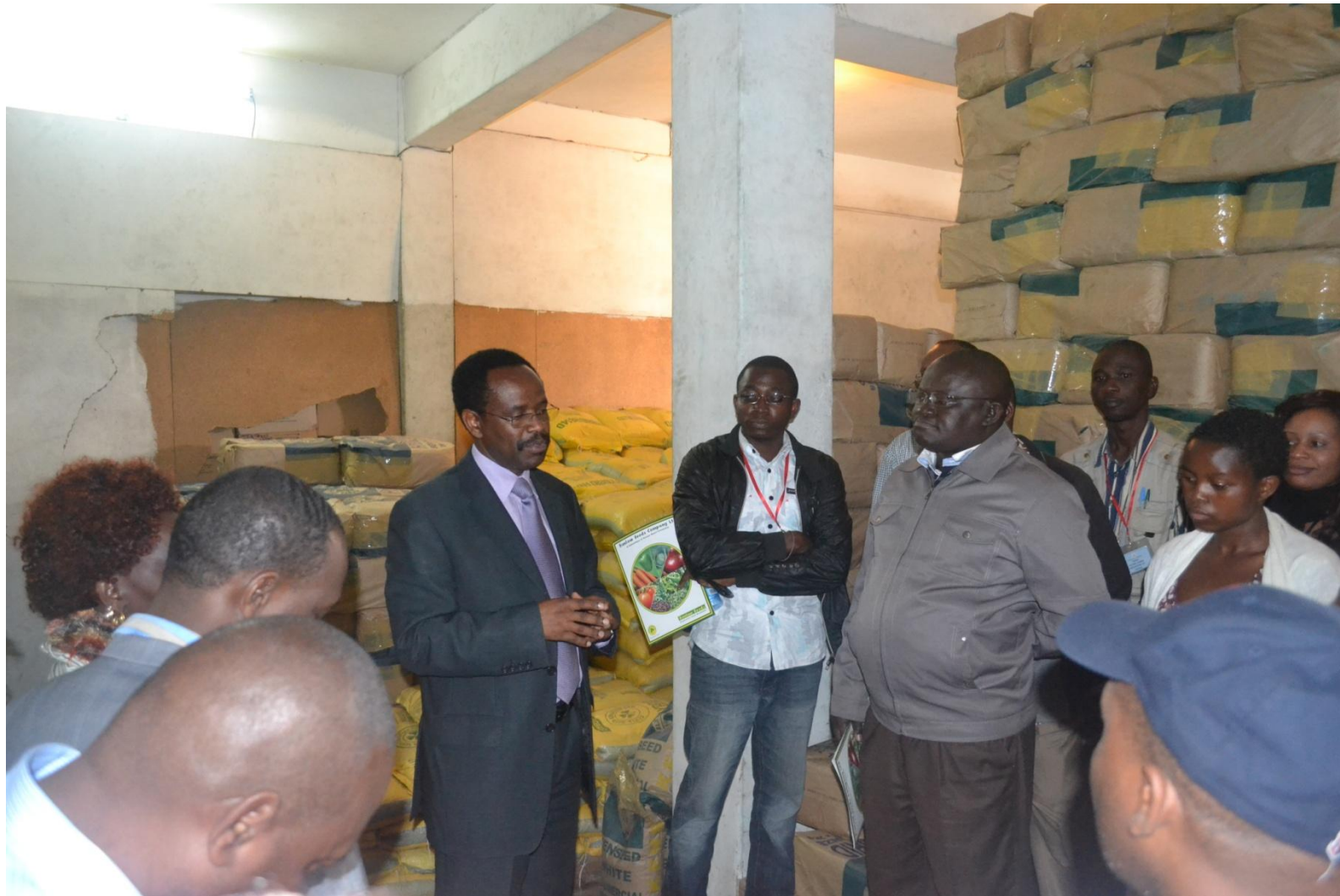
Highlights contd:

Seed Production May 2012:

Visit to KARI Wheat Rust Resistance Breeding Station-Njoro



Seed Marketing Course-July 2012



Participants with the MD-Simlaw Seed company Mr. Soi

Seed Business Management-2013



Visit to Dry land Seed company seed store in Machakos

Seed Processing Course 2014



Familiarization with Certified seed packaging at a seed company in Kenya

Working with consultants to enhance capacity Building



Seed Business Class with Dilip Gokhale

Graduation –Certificate presentations:



Joe DeVries-Director Pass presents certificate and books to participants



Prof. Mwang'ombe-SEMI's PI presenting a certificate to Janet Gyima from Ghana

Rewarding our Participants with certificates at the end of each course motivates them to be better “seed men”

Comments from Participants:

*“I like every topic we did in this course especially seed certification and de-taselling “
Anonymous .*



*“The knowledge I have acquired through the course will be highly valued not only in our seed company but in the whole of Zambia”
Dorica Banda
Indigenous seed company Zambia*



*“Previously I did not know how to project seed requirements and coordinate backwards for procurement of basic, pre-basic seed...” Now I know”
Mr Omari Mduruma-
Aminata seed company
Tanzania*

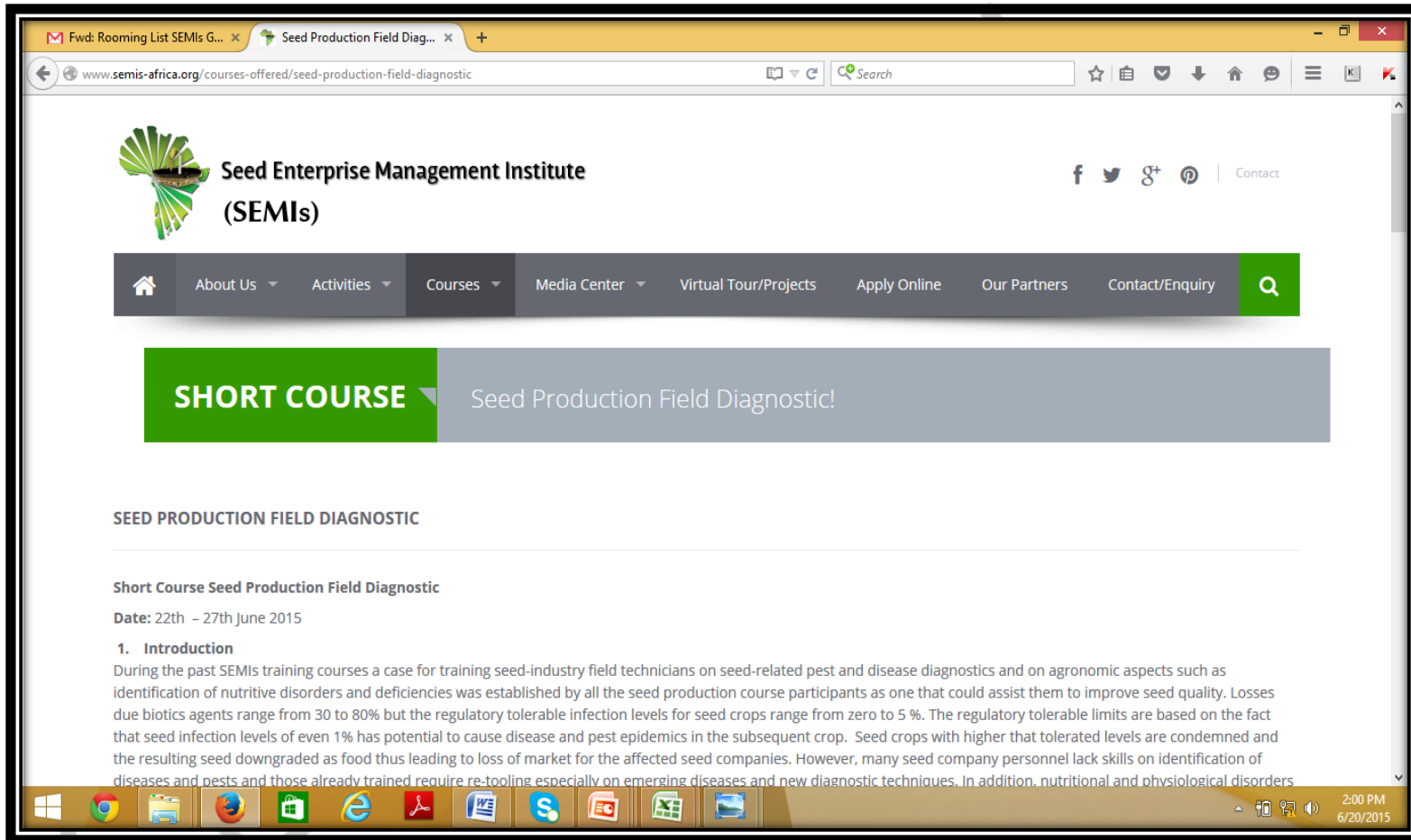
Monitoring and Evaluation:

A monitoring and Evaluation team from AGRA visited SEMIs on 19th February 2012 to assess the project



SEMIs Website:

www.semis-africa.org



The screenshot shows a web browser window displaying the SEMI Africa website. The browser's address bar shows the URL www.semis-africa.org/courses-offered/seed-production-field-diagnostic. The website header features the SEMI logo (a stylized green fan) and the text "Seed Enterprise Management Institute (SEMIs)". Social media icons for Facebook, Twitter, Google+, and Pinterest are visible, along with a "Contact" link. A navigation menu includes "About Us", "Activities", "Courses", "Media Center", "Virtual Tour/Projects", "Apply Online", "Our Partners", and "Contact/Enquiry". A prominent green banner reads "SHORT COURSE" and "Seed Production Field Diagnostic!". Below this, the page title is "SEED PRODUCTION FIELD DIAGNOSTIC". The main content area begins with "Short Course Seed Production Field Diagnostic" and "Date: 22th - 27th June 2015". The first section is titled "1. Introduction" and contains text about seed quality, pest and disease diagnostics, and the importance of training field technicians. The text is partially cut off at the bottom of the screenshot.

- Sharing information on seed issues, current happenings in the seed industry in Africa
- Staying in touch with SEMI participants
- Online registration of Students



Thank you for
your attention



SEED BUSINESS

SEMS - UON

- By Aline O'Connor

Contents

1. Critical Thinking
2. Key Success Factors in the Seed Business
3. Managerial Skills
4. Performance Management and Team Building

Critical Thinking Skills

Aline O'Connor

Business Management Module

SEMIs

Quiz: What is Critical Thinking?

What does the phrase “critical thinking” mean?

- a. Thinking about important things in business
- b. Criticizing a bad situation when there are problems
- c. Using your brain to creatively anticipate, identify, and solve potential problems
- d. Implementing answers other people have given you

Critical Thinking ...

- ✓ Your most important job
- ✓ The most important skill to look for in your senior managers

Simple Truth: In some cases,
to engage in critical thinking,
you must have some solid facts
to think about!

Simple Truth: In some cases, to engage in critical thinking, you must have some solid facts to think about!

Numbers, records, analysis

Otherwise you are just guessing, not engaging in critical thinking

How to recognize critical thinkers

They:

- Think beyond “what’s in front of them”
- Think cross-functionally (e.g., how does production impact finance? Or marketing?)
- Look at opportunity costs
- Seek all pertinent information to solve a problem
- Learn from their mistakes
- Get excited about sharing what they have learned
- Think “what is the best thing to do here”









How to recognize critical thinkers: Are YOU one?

- Think beyond “what’s in front of you”
- Think cross-functionally (e.g., how does production impact finance? Or marketing?)
- Look at your opportunity costs
- Seek all pertinent information to solve a problem
- Learn from your, and your company’s, mistakes
- Get excited about sharing what you have learned
- Think “what is the best thing to do here”

Three Critical Thinking Exercises

1. Human resources problem
2. Production problem
3. Input supply problem (getting parent seed)

“No expert knows everything about every place, not even everything about any place. If one’s knowledge of one’s whereabouts is insufficient, if one’s judgment is unsound, then expert advice is of little use.”

Wendell Berry

Key Success Factors in the Seed Business

Aline O'Connor

Business Management Module

Financial Dictionary

Definition: **entrepreneur**

A risk-taker who has the skills and initiative to establish a business.

Financial Dictionary

Definition: **entrepreneur**

A risk-taker who has the skills and initiative to establish a business.

In our cases, a SEED business!

No single element of running a seed company is extremely difficult.

SEMIS - UOK

SEMI's



No single element of running a seed company is extremely difficult.

The difficult part is that you need to do so many things at the same time!

*Do you know how to
produce high quality,
cost-effective seed?*

SEMS -



*Can you attract and keep
customers?*

SEMIS -

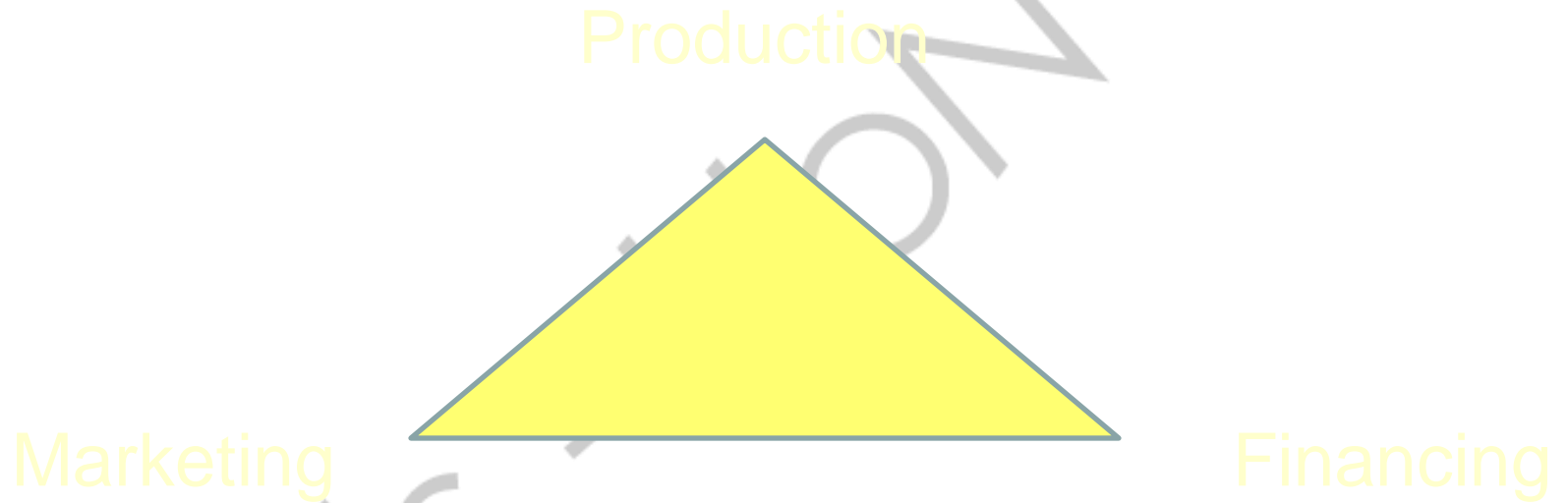


*Do you know how to keep
score?*

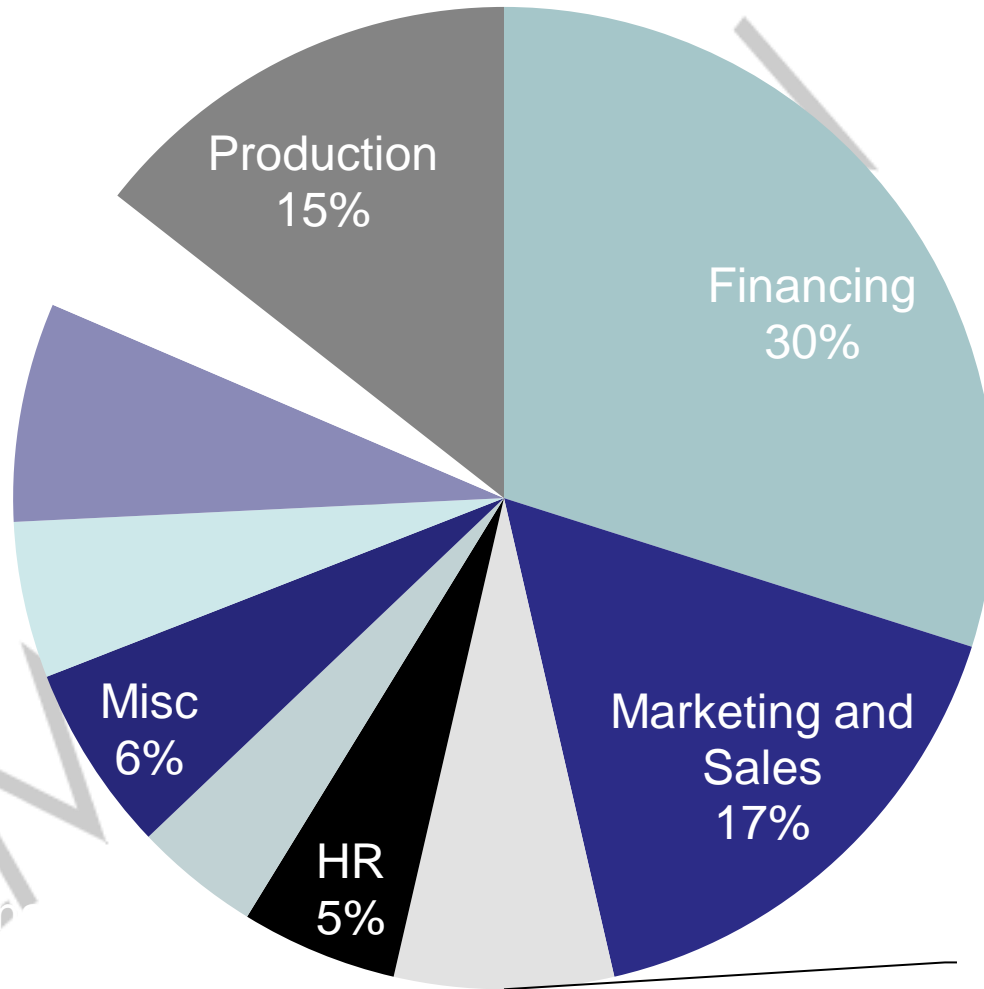
SEMS -



Three Key Capabilities



SEMIs



SEM
M

SEMI's

56%



Key Success Factors

In the seed business, key success factors relate to these three functions – production, marketing, and financing – and how to accomplish them.

Accomplishing them well involves your team, your ability to plan, and your ability to execute.

#1: High Quality Production

You have to produce something in order to sell it!

It has to be very good for people to believe in you

Tool #2: The Enemies of Seed Quality

#2: Cost Effective Production

Anybody can spend a fortune to produce high quality seed – but not everyone can produce high quality seed cost-effectively

Tool #7: 10 Major Production Bleeders

#3: Good Marketing

Customers must understand the benefits of your product in order to decide if it is worth buying (or, in the case of seed, investing in.)



Farmers buy seed two ways:

Rational

Price

Performance

Convenience

Packaging

Data

'Academic'

recommendation

Emotional

Value

Trust

Person selling

Visual appeal

Choice of peers

"How I'm treated as

a customer"

Trust

- Doing what you say you are going to do
- Putting your customer first



Cannot over-emphasize

trust

in the seed industry

SEMIs



#4: Financial Resources

Profits / Retained Earnings

Investors

Good banking relationship

Why are these so important?

#4: Financial Resources

1. Access to capital for FS, equipment, other
2. Climactic conditions
3. Technical skills – each person has different skills
4. Marketing seeds given low buying culture
5. Balancing financial constraints with seed production requirements
6. High competition
7. Low availability of BS
8. Lack of modern equipment
9. Planning and coordination
10. Executing plans
11. Cash flow/staying afloat

#4: Financial Resources

1. Access to capital for FS, equipment, other
2. Climactic conditions
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11. Cash flow/staying afloat

#4: Financial Resources

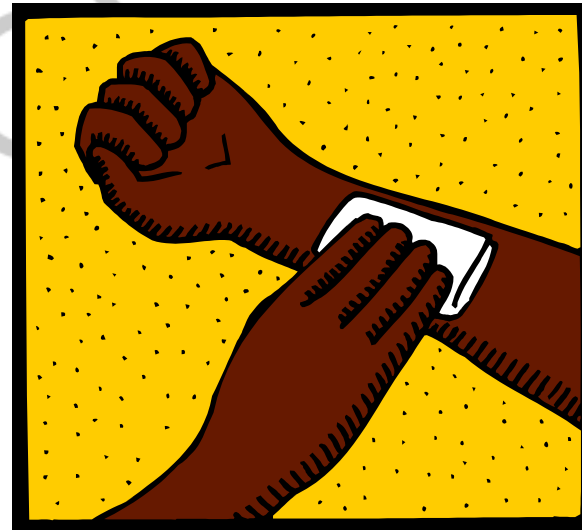
Know how to keep score!

Honesty before the numbers

Profit is like blood; without it
you will die

Cash Flow

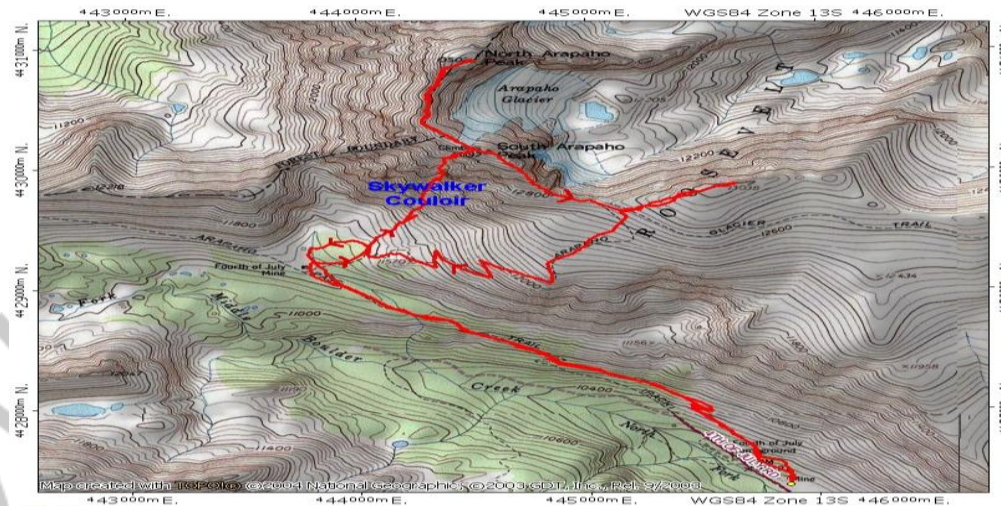
Feeders and Bleeders



SEMIs

#5: *Good planning skills*

Have a plan for your safari.



Then make a new plan.

#4: Good Planning Skills

- ✓ Foundation seed planning
- ✓ Outgrower recruitment and training
- ✓ Production planning
- ✓ Input acquisition
- ✓ Demos
- ✓ Agrodealer recruitment
- ✓ Distribution
- ✓ Processing “bottleneck”
- ✓ Packaging decisions
- ✓ On and on...!

WHEN PLANNING, CLEAR
WRITING IS A SIGN OF
CLEAR THINKING

KEEP IT SIMPLE

#6: Execution

Product execution
&
Business execution

Product... The Simple Rule

*It's not good enough if
you wouldn't plant it
on your own farm*

Business Execution...

Fortune magazine survey

Why CEOs Fail



Fortune magazine survey:

What is the primary reason American CEOs get fired?

- a. Lack of strategy
- b. Poor financial results
- c. Incorrect vision
- d. Poor team-building
- e. Lack of execution

Why CEOs Fail

“It's rarely for lack of smarts or vision. Most unsuccessful CEOs stumble because of one simple, fatal shortcoming.”

Fortune magazine

Why CEOs Fail

“It's bad execution. As simple as that: not getting things done, being indecisive, not delivering on commitments.”

“So how do CEOs blow it? More than any other way, by failure to put the right people in the right jobs—and the related failure to fix people problems in time”

#6: Execution

How much time do you spend on it?

Distractions –

too much travel and entertainment,
too much ‘advocacy/PR work’,
too much ‘acting like a CEO’ instead of
‘being a CEO’

Keep it real. Stay grounded, stay focused.

“There are no shortcuts to
anywhere worth going.”

Anonymous



#7: Ability to build and keep a good team

Simple truth: YOU CANNOT DO THIS ALONE!!!

Survey question:

What's most important in a job?

People responded they wanted to:

1. *Be on a good team*
2. *Have a voice in the decision-making*
3. *Know their efforts are appreciated*

Hire slow, fire fast

SEMIs

In summary,
you are an **owner** who must
be able to implement these
7 Key Factors for Success



What Do Owners Do?

- ⇒ Transcend functional boundaries
- ⇒ Don't have the answers - find them
- ⇒ Deal in a 360° realm
- ⇒ Think long term
- ⇒ Know that their team drives success
- ⇒ Take personal risk
- ⇒ Are responsible for the “business score”

“Opportunities are usually disguised as hard work, so most people don’t recognize them.”

Ann Landers





SEMIs



"Some people regard private enterprise as if it were a predatory tiger to be shot. Others look upon it as a cow that they can milk. Only a handful see it for what it really is -- the strong horse that pulls the whole cart."

Winston Churchill

SEMIs



Managerial Skills

SEMIs Business Management Module

Aline O'Connor

Tool #32 – HABITS OF STRONG SEED COMPANY MANAGERS

Running a good seed company does not depend on doing a few things well – ***it depends on doing a lot of things well!***

Occasionally reviewing this checklist will help you focus on the most important things you need to be doing as a senior manager.

Tool #32 – HABITS OF STRONG SEED COMPANY MANAGERS

- 1. *Always* pay attention to seed quality!** No exceptions, no shortcuts. Poor-quality seed will cost you money and will cause your customers to make lower yield.

Seed Quality

- Seed is not grain!!!!
- I have seen:
 - Trucks driving on seed
 - Harsh threshing methods
 - Shelling that kills 20% of the seed
 - Seed being cooked
 - Seed being ruined in storage – moisture, weevils, heat, age
 - Seed is a fragile, living thing! Grain is not.

Tool #32 – HABITS OF STRONG SEED COMPANY MANAGERS

2. **Constantly look at your business through the eyes of your customers—the farmers.** This should include looking at purchasing convenience, pricing, packaging, and your educational approach, from their perspective.



Tool #32 – HABITS OF STRONG SEED COMPANY MANAGERS

3. **Set clear, attainable goals for your team.**

Goals are important for your team to understand and accept. Make sure that each member of the team understands how their actions will contribute to accomplishing the goal.

Tool #32 – HABITS OF STRONG SEED COMPANY MANAGERS

4. Plan ahead! Do not run your business day to day, week to week, or month to month.

Despite the many small crises that will inevitably arise each week, good managers plan ahead and keep the team focused on accomplishing the plan.

Planning Exercise

You are making a decision about 20 ha of outgrower hybrid maize seed production. You do not have enough money to help the outgrower purchase fertilizer. So the outgrower uses only half the recommended amount. Instead of making 3 t/ha, the outgrower makes only 2.3 t/ha. What is your opportunity cost of not making sure that all of the fertilizer is applied?

Opportunity Cost

The cost of the opportunity that you are missing!

In this case, how much revenue are you missing?

What is your opportunity cost here?

- 20 ha with 2.3 t/ha yield instead of 3 t/ha yield
- Hybrid maize sells for \$2 USD/kg

This is due to lack of ***planning!***

Tool #32 – HABITS OF STRONG SEED COMPANY MANAGERS

5. Communicate regularly with your team about successes, challenges, and changes.

The importance of communicating with your team cannot be overstated. Regular team meetings are excellent communication vehicles and provide good opportunities for all team members to exchange views and information and ask questions.

Tool #32 – HABITS OF STRONG SEED COMPANY MANAGERS

- 6. Stay calm, especially when there are problems.** Leadership is an important responsibility, and clear thinking in the midst of a challenge is critical.

Tool #32 – HABITS OF STRONG SEED COMPANY MANAGERS

- 7. Create an atmosphere of open debate; do not discourage your team from voicing independent opinions about what is best for the company and your customers. You will miss out on excellent ideas and creative thinking if you create an atmosphere where your team is afraid to voice their own opinions.**

Tool #32 – HABITS OF STRONG SEED COMPANY MANAGERS

8. Show extra appreciation to your team members when they do a good job. Recognition is a powerful motivator. Regularly look for opportunities to recognize your employees for doing things *right*! Often, it is the small, unexpected rewards that are the most meaningful.



Tool #32 – HABITS OF STRONG SEED COMPANY MANAGERS

9. Hire people based on skills and merit, not based on connections. Your entire team will work harder and be more confident about the future of the company if they recognize that you are building the company around strong performers, not around personal connections and preferences.

Tool #32 – HABITS OF STRONG SEED COMPANY MANAGERS

10. “Manage by walking around,” often referred to as MBWA. The best managers are close to the activities of the company, observe work personally, and understand first-hand the challenges and successes of the company. It is very hard to build this knowledge from your office or your car. You need to interact informally with your team—observing and coaching them—as they are working.

Good MBWA – 6 steps

1. Identify what people are doing RIGHT!
2. Identify areas for improvement
3. Ask them for their ideas for improvement
4. Explain WHY the improvement is good for the company and good for them
5. Thank them for their good ideas, and for the work you know they will be doing
6. Ask them to communicate back to you about the improvement

Thank you
Asante Sana
Merci Beaucoup
Obrigado

SEMIS

Performance Management and Team Building

SEMIs Business Management Module

Aline O'Connor

What, exactly, do we mean by

“Performance”?

“Management”?

What, exactly, do we mean by

“Performance”

Against what? By when? How?

Costing what?

What, exactly, do we mean by

“Management”

Define, Ask, Monitor, Coach,
Inspire, Correct, Reinforce

Performance Management

1. Explain the “big picture”, the vision
2. Define the job, and the person’s role
3. Define the expectations
4. Provide the required support/tools
5. Backstop as necessary (initially), coach
6. Measure performance
7. Provide feedback

Performance Evaluation

- Must start with goals and expectations!
- When possible, make *specific*
- Should also include “soft goals”, for example:
 - Mentoring less experienced colleagues
 - Improving customer focus
 - Doing completed work
- At end of period, both employee and employer evaluate separately, then compare

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High

7

8

9

Medium

4

5

6

Low

1

2

3

Low

Medium

High

SKILL

SEMI'S - UON

**A
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High

7. "Test" and Train

8. Train and Advance

9. Treat like a star!

Medium

4. Coach and Train

5. Coach and Train

6. Coach

Low

1. Fire

2. Fire

3. Warn

Low

Medium

High

SKILL

Team Building

- As a group, set team goals, and identify timeframe
- Discuss how each person plays a role
- Keep team up to date on progress
- Meet to discuss challenges and successes!
- Talk about outcome, identify what worked, didn't work
- Give positive reinforcement, but also be honest about problems
- Reward performance
- Have fun together!

- By Dr. Vincent Machuki

SEMIS - UON

Contents

1. Business Growth
2. Corporate Governance

SEMIS - UON

UNIVERSITY OF NAIROBI
Seed Enterprise Management Institute
(SEMI)
Seed Business Management Course

BUSINESS GROWTH

Dr. Vincent Machuki

School of Business

A. Introduction

- ❖ Business failure rates are alarming with incredibly consistent statistics globally.
- ❖ Failure rates in the 95% range in the first five years
- ❖ Why?

❖ What is business failure?

❖ Closing shop?

❖ Switching business?

❖ Slowed growth?

B. Failure Points

- ❖ Start Up – entry and survival challenges
- ❖ Growth – growth challenges

1. Start Up Challenges

- ❖ New ventures have two critical liabilities:
 - Liability of Size and
 - Liability of newness.
- ❖ The "liability of newness" concept includes small size as one reason for the high risk of failure of new businesses.

❖ Largely due to:

- Resource constraints
- Lack of economies of scale
- Image problems
- Lack of learning/experience

Consider this:

There are assets of newness and size:

- Innovation
- No unlearning
- Focus and energy
- No liabilities of history

B. Understanding Growth

- ❖ The transition from a small company to a growing company is often characterized by a transition *from* owner-managed *to* owner-directed by moving:

From

- being managed and run by the founder(s),

To

- one which has begun to contract-in specialist expertise from outside and to obtain finance from outside sources.

- ❖ Good businesses have the potential for growth.
- ❖ While startups cannot do much in terms of their age, they can avoid the liability of smallness through fast growth.
- ❖ Past growth enables a firm to increase the likelihood of future survival.
- ❖ Firms benefit from a sustained growth pattern.

- ❖ Growth may be gradual, or fast, depending on several factors; markets growth rate, environment and management capability.
- ❖ Business growth can be measured in terms of employment, assets value, sales turnover, or market share.

C. Achieving Business Growth

❖ Business growth can be achieved through increasing the existing production capacity to meet increasing demand e.g.

- Opening new branches
- New lines of business
- Merging with another firm
- Buying other business

- ❖ Growth requires careful thought and research.
- ❖ If not properly managed it can lead to demise of the business.
- ❖ Growth leads to strain on the resources; staff, finances, supplies, equipment etc.
- ❖ Growth can also lead to emergence of competition and changes in the market conditions.

❖ If growth is well managed it can be very rewarding to an entrepreneur, leading to:

➤ More finances

➤ More staff

➤ More recognition

➤ Better living standards

➤ Achievement

D. Growth Model: S-Curve

Stage 1: Conception/Existence

- Business not in existence
- Owner and business are same
- No formal systems

Stage 2: Survival

- Business is a workable entity
- Major goal is survival
- Ltd staff
- Formal planning is ltd.

Stage 3: Profitability and Stabilization

- Business grown and profitable
- Engaged business managers
- Developed systems
- Emerging entity status for the business

Stage 4: Profitability and Growth

- Growth is the focus
- Recruits growth staff
- Strategic focus is clearer

Stage 5: Take-off

- Delegation is full
- Owner weaknesses clearer
- Delegation a must

Stage 6: Maturity

- Management decentralized
- Necessary resources in place
- Need for Intrapreneurship

2. Challenges During Growth

1. Existence

❖ **Concerns:** Obtaining customers and delivering the product or service contracted for.

❖ **Key Questions:**

i. Can you get enough customers, deliver your products, and provide services well enough to become a viable business?

ii. Can you expand from that one key customer or pilot production process to a much broader sales base?

iii. Do you have enough money to cover the considerable cash demands of the start-up phase?

□ ***How did we confront these questions?***

2. Survival

- ❖ Business is workable entity
- ❖ Has enough customers and satisfies them sufficiently with its products or services to keep them
- ❖ **Key problem:** Relationship between revenues and expenses.
- ❖ **Key Questions:**
 - i. In the short run, can you generate enough cash to break even and to cover the repair or replacement of your capital assets as they wear out?
 - ii. Can you, at a minimum, generate enough cash flow to stay in business and to finance growth to a size that is sufficiently large, given your industry and market niche, to earn an economic return on your assets and labor?

3. Success

❖ **Decision facing the owner(s):** whether to exploit the company's accomplishments and expand or keep the company stable and profitable, providing a base for alternative owner activities.

❖ **Key Concern:** Whether to use the company as a platform for growth, or as a means of support for the owners as they completely or partially disengage from the company.

❑ *Are we in this stage?*

❑ *What decision have we made??*

- ❖ Company has attained true economic health, has sufficient size and product-market penetration to ensure economic success, and earns average or above average profits.
- ❖ Grown large enough to require functional managers to take over certain duties performed by the owner.
- ❖ Cash is plentiful and the main concern is to avoid a cash drain in prosperous periods to the detriment of the company's ability to withstand the inevitable rough times.
- ***Does these characterize our companies?***

- ❖ First professional staff members should come on board.
- ❖ Basic financial, marketing, and production systems should be in place.
- ❖ Planning in the form of operational budgets should support functional delegation.
- ❖ Owner, and managers, to a lesser extent, should be monitoring a strategy to essentially maintain the status quo.

❖ Owner can take the cash and the established borrowing power of the company and risk it all in financing growth.

❖ **Important:** make sure the basic business stays profitable so that it will not outrun its source of cash and to develop managers to meet the needs of the growing business.

➤ Requires hiring managers with an eye to the company's future rather than its current condition.

➤ Install systems with attention to the forthcoming needs.

➤ Deeper involvement of strategic planning by the owner

❑ *What have we done or are we doing?*

4. Take-off

❖ **Key problems:** how to grow rapidly and how to finance that growth.

❖ Most important questions are in:

i. **Delegation:**

- Can the owner delegate responsibility to others to improve the managerial effectiveness of a fast growing and increasingly complex enterprise?;
- Will the action be true delegation with controls on performance and a willingness to see mistakes made, or will it be abdication, as is often the case?

❑ *Are your companies in this stage?*

❑ *How could you respond to the above questions?*

ii. Cash: Has there been enough cash to satisfy the great demands growth brings (tolerating a high debt-equity ratio) and a cash flow that is not eroded by inadequate expense controls or ill-advised investments brought about by owner impatience?

❖ Characterized by decentralization and divisionalization usually in either sales or production.

❖ Key managers must be very competent to handle a growing and complex business environment.

- ❖ A pivotal period in a company's life:
 - If the owner rises to the challenges of a growing company both financially and managerially, it can become a big business;
 - If not, it can usually be sold-at a profit-provided the owner recognizes his or her limitations soon enough.

5. Resource Maturity:

❖ Greatest concerns:

- to consolidate and control the financial gains brought on by rapid growth, and
- to retain the advantages of small size including flexibility of response and the entrepreneurial spirit.

❖ Important:

- Expand the management force fast enough to eliminate the inefficiencies that growth can produce and professionalize the company by use of such tools as strategic planning, BPR, EPR, balance score card, and standard cost systems without stifling its entrepreneurial qualities.

❖ If it can preserve its entrepreneurial spirit, it can and will be a formidable force in the market.

❑ *Are our companies at this stage?*

❑ *How are we addressing the key concerns raised above?*

❖ Take care not to enter the sixth stage: **Ossification**, i.e. a lack of innovative decision making and the avoidance of risks.

- ❖ There should be staff and financial resources to engage in detailed operational and strategic planning.
- ❖ Management should be decentralized, adequately staffed, and experienced.
- ❖ Systems should be extensive and well developed.
- ❖ Owner and the business should be separate, both financially and operationally.
- ❖ Company has arrived; exploit the advantages of size, financial resources and managerial talent.

E. Why Entrepreneurs Fail in Managing Growth

- ❖ The very traits that lead people to start the business i.e. ambition, creativity, self-confidence, obsession, etc. can lead to problems for the business at the growth stage.
- ❖ Growth requires a radical shift in management style.
- ❖ Growth pushes most entrepreneurs to areas that they are not good at.

F. Challenges of Transition

- ❖ Overwhelming entrepreneurial characteristics of ambitions and control leading to obsession.
- ❖ Underdeveloped human resources to be delegated to. Normally caused by:
 - Inability to pay costs of staff development.
 - Inability to recruit and hand over management to professionals
 - Inability to recognize the need for change

- ❖ Tendency of the market to recognize individuals in a business and not the firm.
 - Trusting individuals to deliver
 - Nature of marketing tactics by small enterprises

- ❖ Inability of entrepreneurs to trust others to see their vision as well as they do.

❖ To ensure the successful transition, the company will need to respond to a number of changes in the internal and external operating environment, including:

❖ Overcoming and managing risk

❖ Developing and recruiting skilled people

❖ Managing finances

❖ Dealing with ownership structure

❖ Managing growth and competition

❖ Accessing external sources of finance and expertise

❖ General economic conditions.

G. Signs of Business Failure

- ❖ Customer complaints – inability to meet customer deadlines, lengthening queues
- ❖ Falling quality of products or services
- ❖ Declining sales and profits
- ❖ Increasing costs
- ❖ Liquidity crisis
- ❖ Low staff morale

H. Avoiding Failure

- ❖ You must have a strategy
- ❖ You must have controls
- ❖ The Board must participate
- ❖ You must avoid one-man-rule
- ❖ There must be management in-depth
- ❖ Keep informed of, and react to, change
- ❖ The customer is king
- ❖ Organize to meet employees' needs

Note:

- ❖ Products and services are becoming increasingly commoditized, and one of the only remaining ways to distinguish yourself is in the relationship you have with your customer.
- ❖ It takes effective Strategic Management for a company to become successful and grow.

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UNIVERSITY OF NAIROBI
Seed Enterprise Management Institute
(SEMIs)

Seed Business Management Course

CORPORATE GOVERNANCE

Dr. Vincent Machuki

School of Business

Introduction

- ❖ The basic purpose of all commercial companies is to preserve and enhance the investment which created them, not just in the short term but in perpetuity.
 - ❖ Good governance practices can increase the chances of wealth creation in the short term, but they can make a much greater difference in the longer term, partly through creating confidence in those on whom the company depends.
-

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- ❖ Competitive pressures are growing, community expectations are increasing, and the standards required for success are rising.
 - ❖ Good corporate governance can make a great contribution to success, bad governance makes failure more likely.
 - ❖ Better-governed companies have less management problems.
 - ❖ It is therefore in the interests of **all enterprises** to consider whether they can improve their system of governance.
-

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- ❖ Leading your enterprises to thrive in a competitive world, very often with resource constraints is the enormous challenge you face.
 - ❖ Therefore, you have to be competent in strategic planning and internal control.
 - ❖ Corporate governance addresses both of these areas.
-

Governance and “Good” Governance

- ❖ Governance is not the same as Good Governance.
 - ❖ **“Governance” is:** – “the processes and structures that an organization uses to direct and manage its general operations and program activities”
 - ❖ **Good Governance:** – Achieving desired results and achieving them in the right way.
-

❖ The understanding and implementation of a good corporate governance framework presents SMEs with a structured path to:

- Better management practices,
 - Effective oversight and control mechanisms which lead to opportunities for growth,
 - Financing,
 - Exit strategies,
 - Improved performance,
 - Effective management of relationships among stakeholders, defining their roles and rights.
-

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- ❖ Good governance is underpinned by the principles of openness, integrity, and accountability.
 - ❖ It is about ensuring that those responsible for directing an organization ensure that resources are exclusively devoted to pursuing its defined goals, and account appropriately to shareholders and other stakeholders, who in turn can hold them accountable.
 - ❖ Its objective is to promote strong, viable and competitive companies through efficient functioning of the interplay among different stakeholders.
-

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- ❖ Good corporate governance goes beyond compliance with legislative and regulatory requirements.
 - ❖ It is about embedding the principles of accountability throughout the organization and creating a mechanism of checks and balances.
- SEMS -
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CG Pillars for SMEs

1. Adopt a formal corporate governance framework outlining the roles of the key bodies such as partners, shareholders, board of directors and management.
 - Clarity on how the company is to be governed.
 - Partners' and shareholders' rights and obligations should be clearly set out.
 - Formal delegation of authority.
-

2. Conduct a succession planning process.

- Deliberate development and facilitation of change leadership in a progressive, planned and non-disruptive manner.
 - Assure various stakeholders on the longevity of the company, preserving its reputation and brand value.
 - Should be embedded in the company's strategic planning, addressing both managerial succession and ownership succession.
 - Put in place a rigorous succession planning methodology providing for both planned and emergency scenarios.
-

3. Establish a timely, open and transparent flow of information with shareholders.

- Establish clear lines of communication with shareholders ensuring timely and accurate disclosure of pertinent information.
- Initiate an effective engagement mechanism to gauge the views of shareholders (e.g. AGM).

SEMS

4. Endeavor to set up a formal Board of Directors to accompany the growth of the company.

- A board formalizes the decision making process within the company, adds a layer of checks and balances, and facilitates better strategic thinking.
 - Smaller companies may wish to set up an “advisory” board with no formal decision making powers but which offers its expertise and networks to guide and support the business.
-

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- For entrepreneurs looking for strategic advice, the appointment of 'outside' or independent non-executive directors can be a fast-track to commercial wisdom.
 - Two to three people is a sufficient size for an advisory board for a small business.
 - As the business grows, a formal board of directors should be established with formal procedures.
 - Consider appointing independent board members.
 - New directors should undergo a tailored induction program
-

5. Develop a clear mandate for the Board of Directors to oversee the overall performance of the business.

- Building an effective board takes time and patience and requires the entrepreneur/founder to have a clear vision of what to expect from the board and how it can add value.
 - The board charter should have a clear definition of the role of the board.
 - The board should meet as frequently as necessary for the discharge of its obligations and the agenda topics should include all items it is expected to discuss.
-

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- The board should provide entrepreneurial leadership to the company within a framework of prudent and effective controls which enables risk to be assessed and managed.
 - Boards should undergo regular performance evaluation process and regularly review the composition of the board.
 - With time, consider separating the roles of the chairman and the chief executive officer.
-

6. Maintain credible books of accounts, which are annually audited by an external auditor.

- Any changes in accounting policies should be disclosed and justified in the financial statements.
- Review the effectiveness of the audit process.

7. Set up an internal control framework in place and conduct a regular review of risk.

- Regularly review the risks facing the company, particularly in the case of growth companies which are likely to be facing a new set of risks as they expand.
 - Bear in mind that heightened sensitivity to risk may stifle innovation and creativity, and that risk taking is an essential element in entrepreneurship.
 - Should consider establishing an internal audit function (if it is not yet established).
-

8. Recognize the needs of stakeholders.

- Stakeholders are understood to mean employees, customers, suppliers, creditors, regulators, the community, the environment, and generally any party enjoying relations with the enterprise.
 - View yourselves (the companies) as integral parts of the community in which you operate and are committed to a sound relationship built on respect, trust, honesty and fairness.
 - Formulate policies governing your company's relationship with its stakeholders.
-

9. Formulate a framework setting out the family's relationship with the business.

- If family members are engaged in the business, clear lines of authority and decision-making, policies on employing family members, and clarifying the separation of the family business and the business of the family should be developed.
 - In later generations as the family and business get more complex, families should consider establishing a family governance institution such as a "family council".
-

CG for Different SMEs

- ❖ SMEs can be categorized as:
 1. Small entities owned by single individuals. Operations may involve a few family members.
 2. Larger entities employing non-family people. Owners may include a few family members or outsiders.
 3. Medium sized companies with several shareholders, or unincorporated partnerships.
 - ❖ Understand which CG practices are applicable to your case.
-

Category I:

- ❖ The owner has no need to consider other shareholders or non-family employees.
 - ❖ But he/she will certainly have to:
 - Satisfy customers,
 - Maintain the confidence of suppliers and possibly creditors,
 - Establish a sound reputation in the community in which the enterprise operates.
 - Keep credible accounts and a simple system of internal control which enable the entrepreneur to know what is really going on in the business, and also enable the lenders to accept them as reliable.
-

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- Keep accurate and up to date records of revenue, expenditures, debtors and creditors.
 - Develop a simple, written business or strategic plan which defines the company's objectives and the chosen route for reaching them.
 - Come up with a simple set of performance indicators, including a budget and a system for monitoring debtors and creditors to enable the entrepreneur to monitor whether the company is performing in accordance with the plan.
 - Conduct a simple analysis of the risks facing the company and develop basic policies for managing them to assist the entrepreneur to avoid disaster.
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- Submit audited financial statements (those registered as companies).
 - Have some form of succession plan which should make provision for the continuance of the business if the entrepreneur dies, becomes unable to manage the business, or wishes to retire.

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Category II

- This category of enterprises makes the accounting and internal control process more complex and more important.
 - The entrepreneur may no longer be able to watch over all the operations and may need formal systems to check on activities he cannot supervise directly.
 - The business plan is also more likely to be more detailed and it may need to span a longer time horizon, perhaps three, or even five, years. It will also be more important to review it annually.
-

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- These companies need more performance indicators and the process of collecting the relevant data and presenting it in a usable form will require closer attention. Both financial and non-financial performance indicators will be found to be valuable.
 - A formal process of evaluating the risks facing the organization may be worth the while. It is best to evaluate risks according to the likelihood of occurrence and the consequences if they do occur.
 - Written policies for managing the most serious of the risks are likely to help avoid disaster.
-

-
- If several family members are taking an active role in the company, the succession plan will assume far greater importance and will have to be understood and agreed by the up-coming generation.
 - Simple policies covering remuneration and other human relations issues such as incentives, discipline and dismissal.
 - Managers or executives other than the entrepreneur will have to make some decisions and simple policies to guide decision making will be necessary so that the company is perceived to be consistent and reliable.
-

-
- If capital has been contributed by anyone other than the original entrepreneur, a system must be introduced which allows all concerned to understand the company's financial situation and feel comfortable that they are being treated fairly.
 - Boards of advisers can be appointed by those who control enterprises and asked to provide advice on selected matters.
-

Category III

- Some of the companies in this category may be seeking, or have sought, the investment and assistance of venture capitalists and, as a consequence, have accepted additional disciplines over their operations.
- The entrepreneur will no longer be able to do as he pleases with his company; the law requires him to act in the interests of the company.
- These companies will need a more formalized and robust corporate governance framework.

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Conclusion

- ❖ Understanding and building a foundation of **“GOOD”** corporate governance within your Seed Companies can only contribute to better business practices.
 - ❖ SMEs who start small and build their corporate governance framework with the growth of the business will achieve greater success long-term.
-

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- By Prof. Evans Aosa

Contents

1. Strategic Management For Seed Business In Africa

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STRATEGIC MANAGEMENT FOR SEED BUSINESS IN AFRICA

UNIVERSITY OF NAIROBI

13th July, 2015

SEI



Introduction

“In the global economic race, countries and companies that succeed are the ones with sustainable competitive advantage”.



Strategic Management

- The development and implementation of strategy to achieve corporate success
- The attainment of sustainable competitive advantage
- Adjusting to environmental change
- Ensuring value for money and efficiency



Strategic Management (Cont'd.)

- Learning to do the right things right and better
- Understanding and confronting constraints
- Managing stakeholders



The Process

- Strategic planning
- Strategic implementation



Strategic Planning

- Determining the results an organization intends to achieve in future and how it will achieve them.
 - Where are we now?
 - Where do we want to be?
 - How do we get there?



Strategic Planning

- Vision, Mission & Values
- Strategic Analysis
- Objectives
- Strategies



Strategy Implementation

- Putting strategy into action
- Producing results
- Introducing change in the organization



Strategy Implementation

- Implementing strategy is challenging
- A good strategic plan does not guarantee results: It has to be put into action
- Many excellent strategies fail when attempts to implement them are made



Strategy Implementation

- Institutionalizing the strategy
- Action planning
- Budgeting
- Monitoring and evaluation
 - * Performance contracting



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- By Dr. Peterson Magutu

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CONTENTS

1. Managing Operations

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MANAGING OPERATIONS

**Dr. Magutu, Peterson
Obara (PhD)**

*University of Nairobi, School of
Business*

Département of Management Science

**A Seed Enterprises Management
Institute (SEMI) 2015 Training**

BUSINESS CARD



UNIVERSITY OF NAIROBI

**DEPARTMENT OF MANAGEMENT SCIENCE
SCHOOL OF BUSINESS**

Peterson Magutu
Lecturer

Department of Management Science (SOB)

School of Business
P.O Box 30197-00100
Nairobi-Kenya

Cell: +254 722 109137/ 733204057
Email: magutumop@uonbi.ac.ke
magutumop@yahoo.com

**✘ A Seed Enterprises
Management Institute
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OBJECTIVES

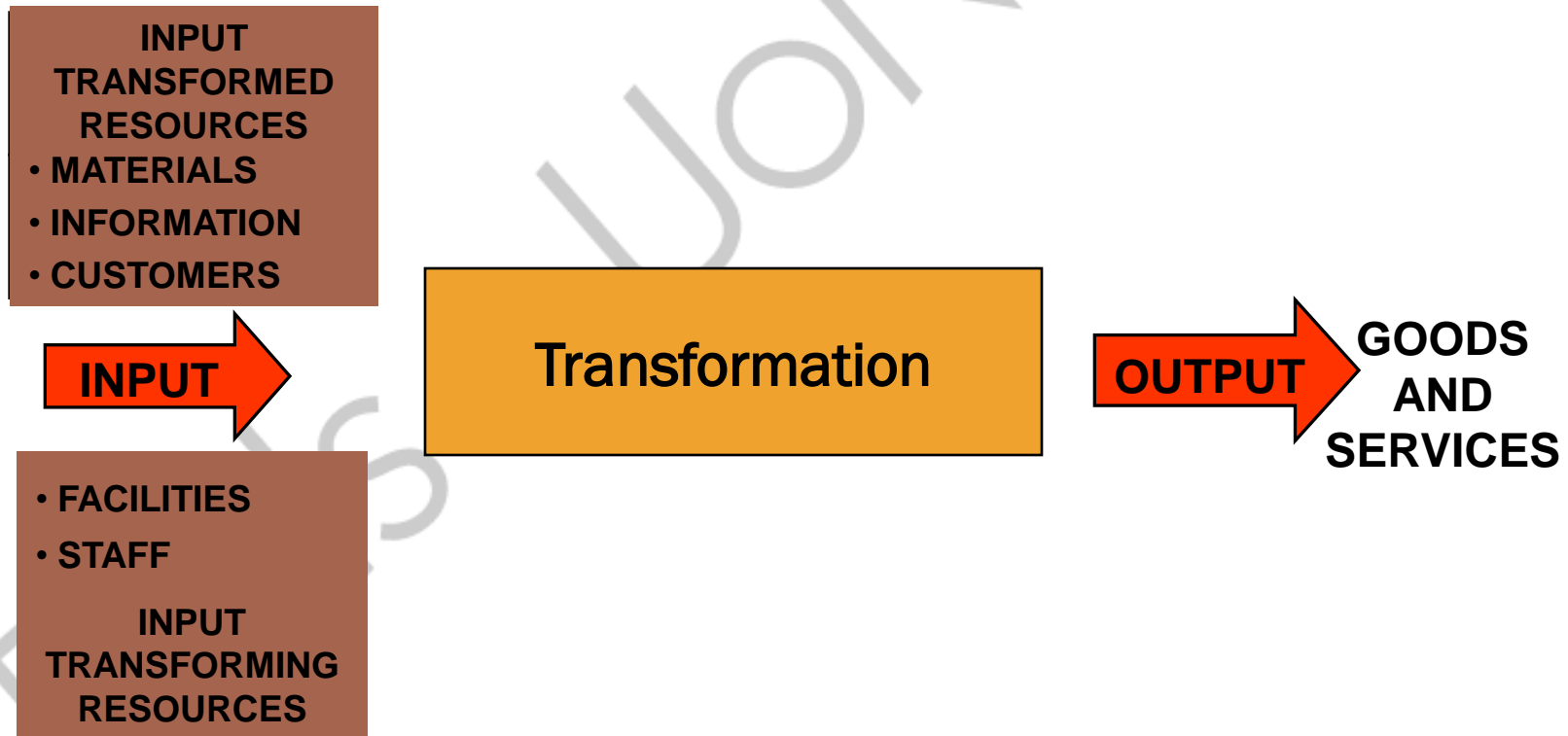
- ✘ Describe basic operations management concepts
- ✘ Describe core operations performance objectives
- ✘ Introduce basic capacity management concepts

INTRODUCTION

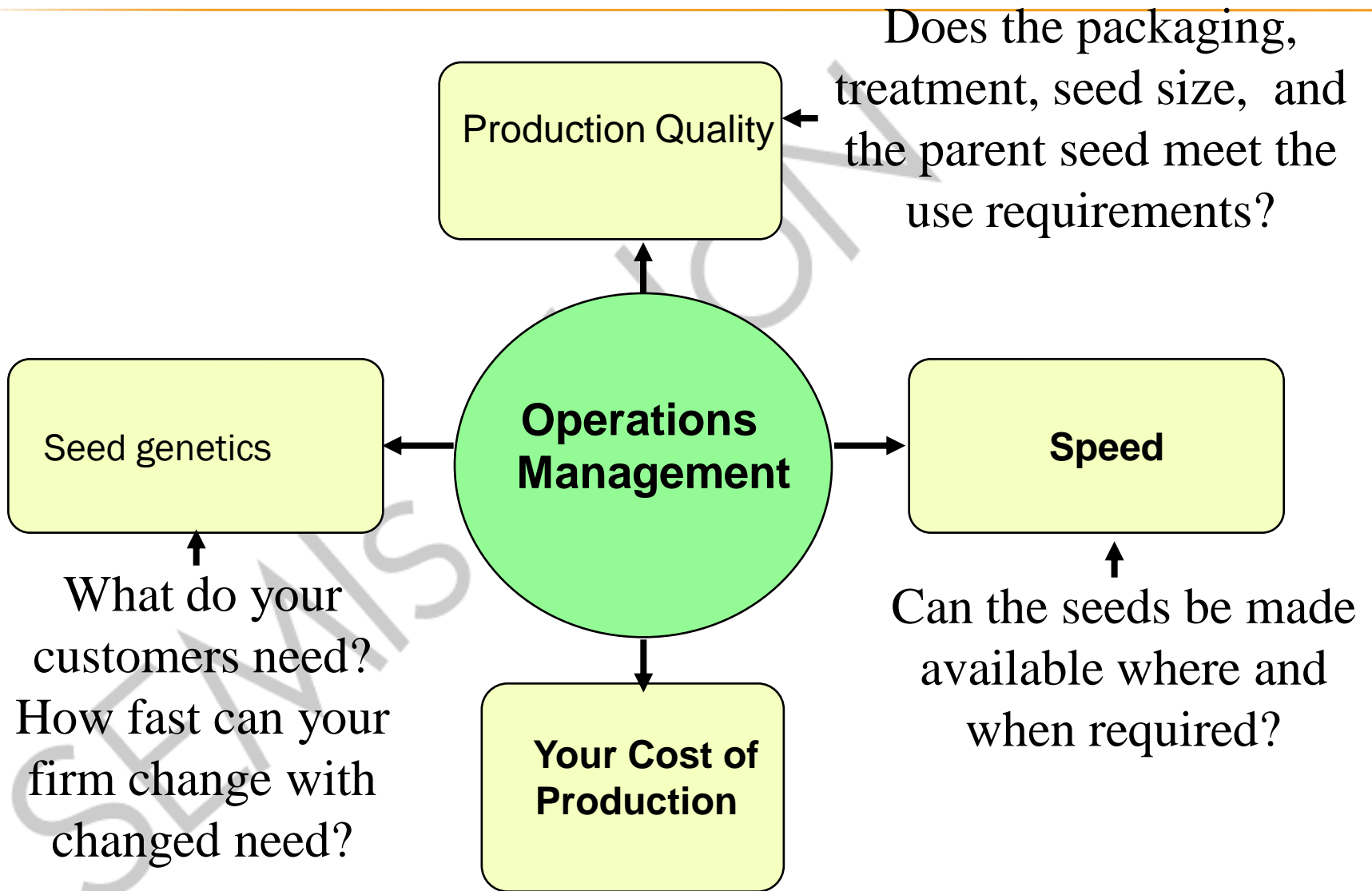
Concept of Operations Management

- ✦ Operations is not just concerned with what goes on at the point of production..., but is also directly concerned with supplying the materials, the location and layout of facilities, the programming of operations and the motivation of employees.

The Activities of Operations Management



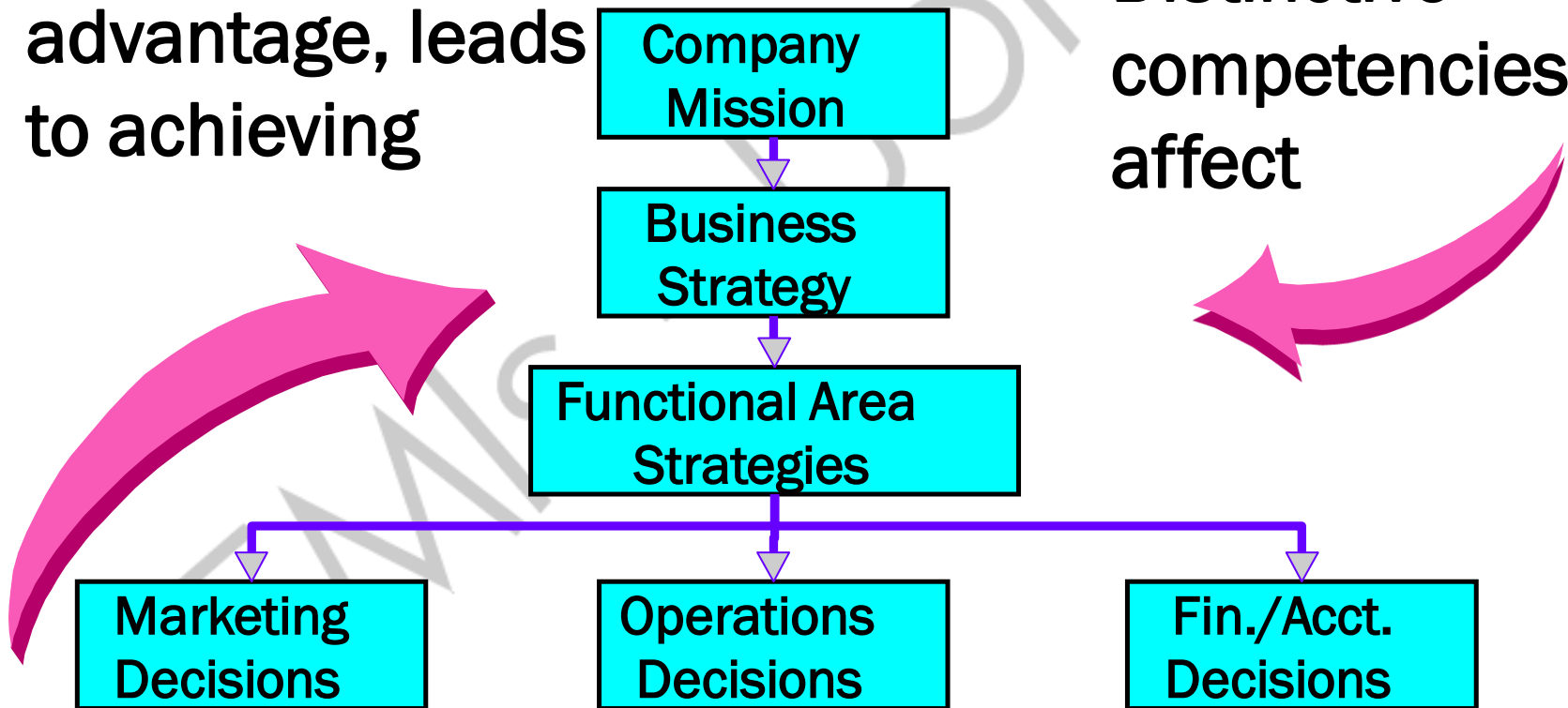
CORE OPERATIONS PERFORMANCE OBJECTIVES



HOW IT WORKS

If competitive advantage, leads to achieving

Distinctive competencies affect



STRATEGIC OPTIONS MANAGERS USE TO GAIN COMPETITIVE ADVANTAGE

- × 28% - Operations Management
- × 18% - Marketing/distribution
- × 17% - Momentum/name recognition
- × 16% - Quality/service
- × 14% - Good management
- × 4% - Financial resources
- × 3% - Other

If one argues that the quality/service categories really belong in OM, the total for OM reaches 44%.

STRATEGIC OPTIONS MANAGERS USE TO GAIN COMPETITIVE ADVANTAGE

- × **28% Operations Management**
 - + Low- cost product
 - + Product-line breadth
 - + Technical superiority
 - + Product characteristics/differentiation
 - + Continuing product innovation
 - + Low-price/high-value offerings
 - + Efficient, flexible operations adaptable to consumers
 - + Engineering research development
 - + Location
 - + Scheduling

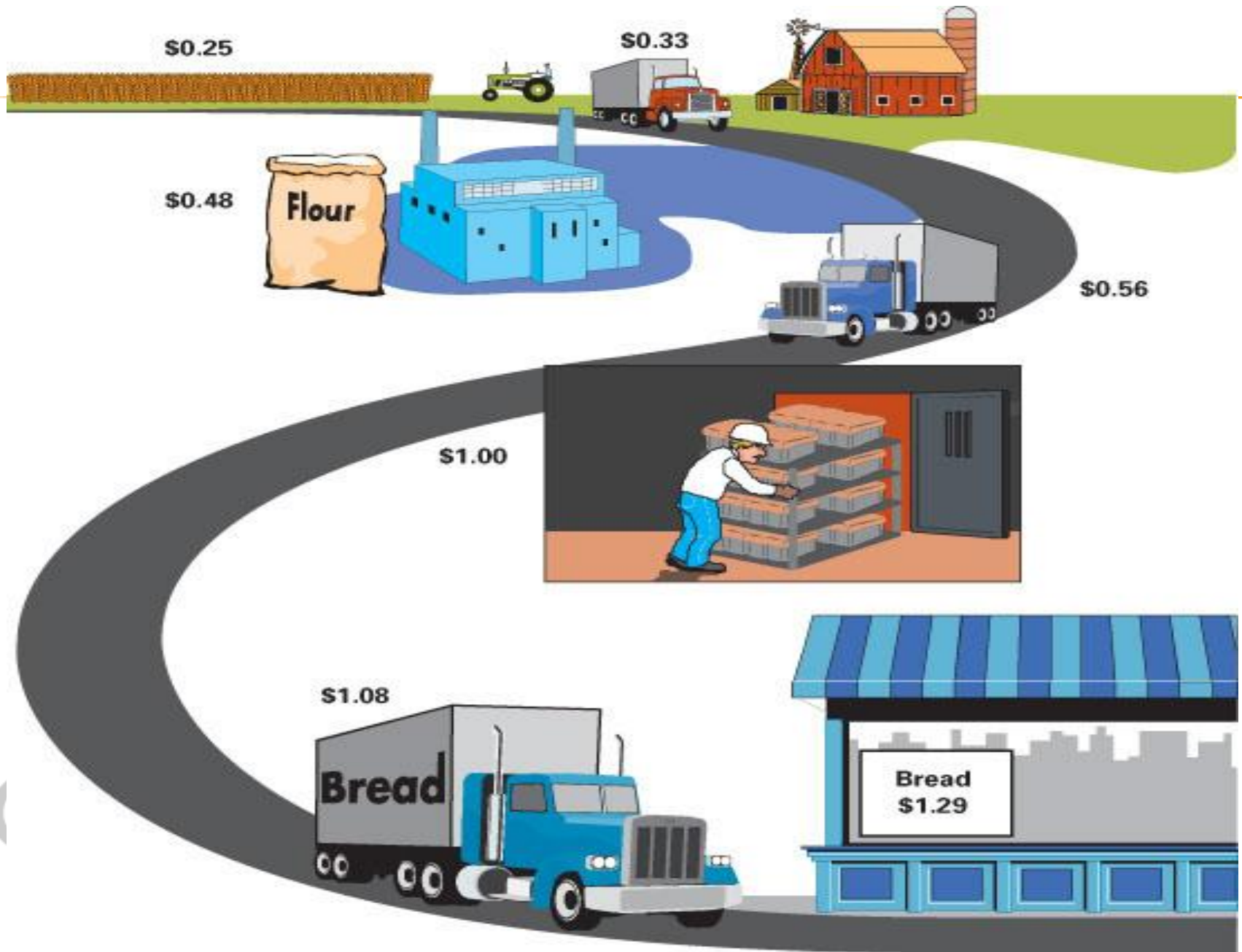
VALUE-ADDED & OPERATIONS MANAGEMENT

- ✘ Value-added is the difference between the cost of inputs and the value or price of outputs.

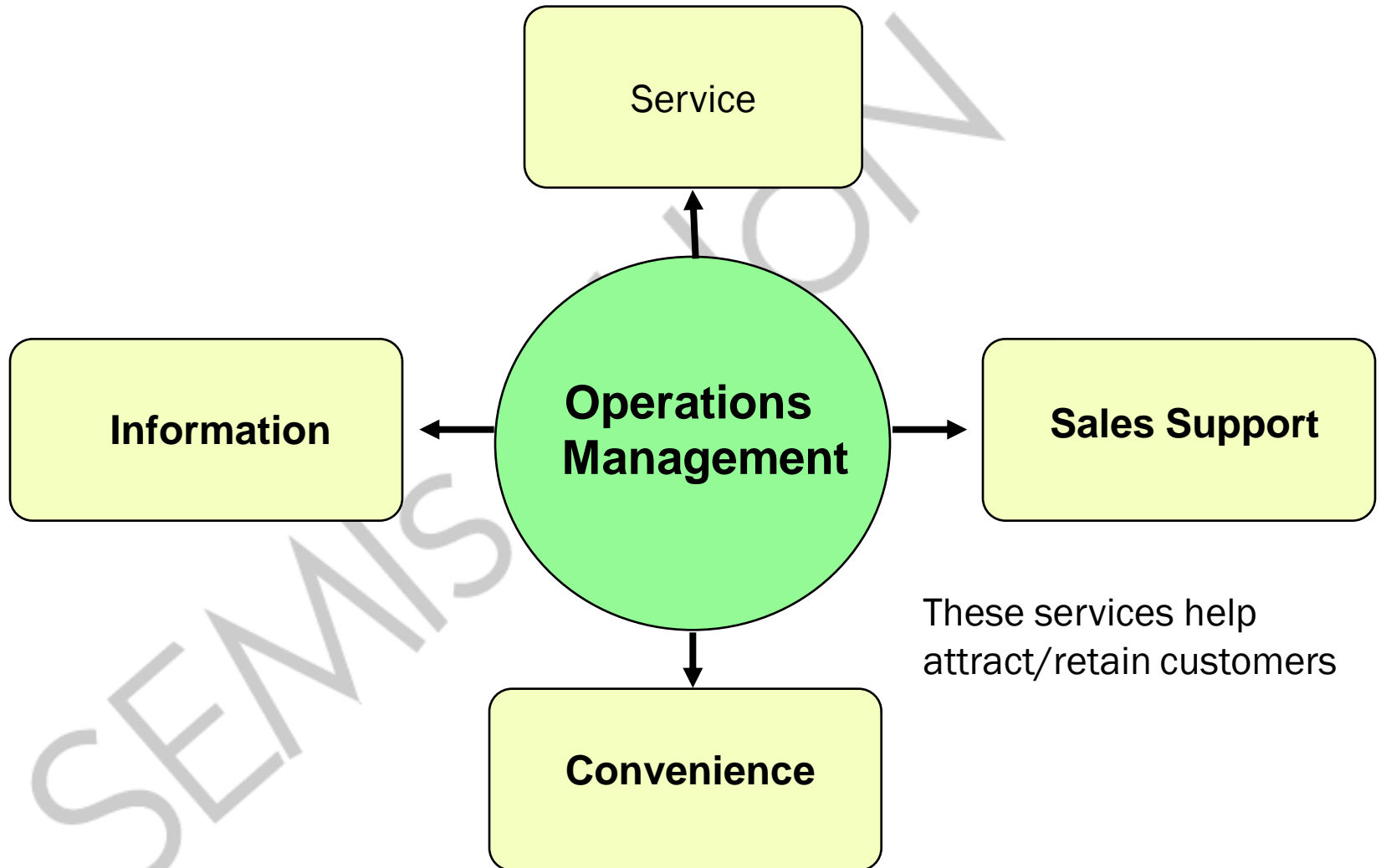
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A Supply Chain for Bread

Stage of Production	Value Added	Value of Product
Farmer produces and harvests wheat	\$0.15	\$0.15
Wheat transported to mill	\$0.08	\$0.23
Mill produces flour	\$0.15	\$0.38
Flour transported to baker	\$0.08	\$0.46
Baker produces bread	\$0.54	\$1.00
Bread transported to grocery store	\$0.08	\$1.08
Grocery store displays and sells bread	\$0.21	\$1.29
Total Value-Added	\$1.29	



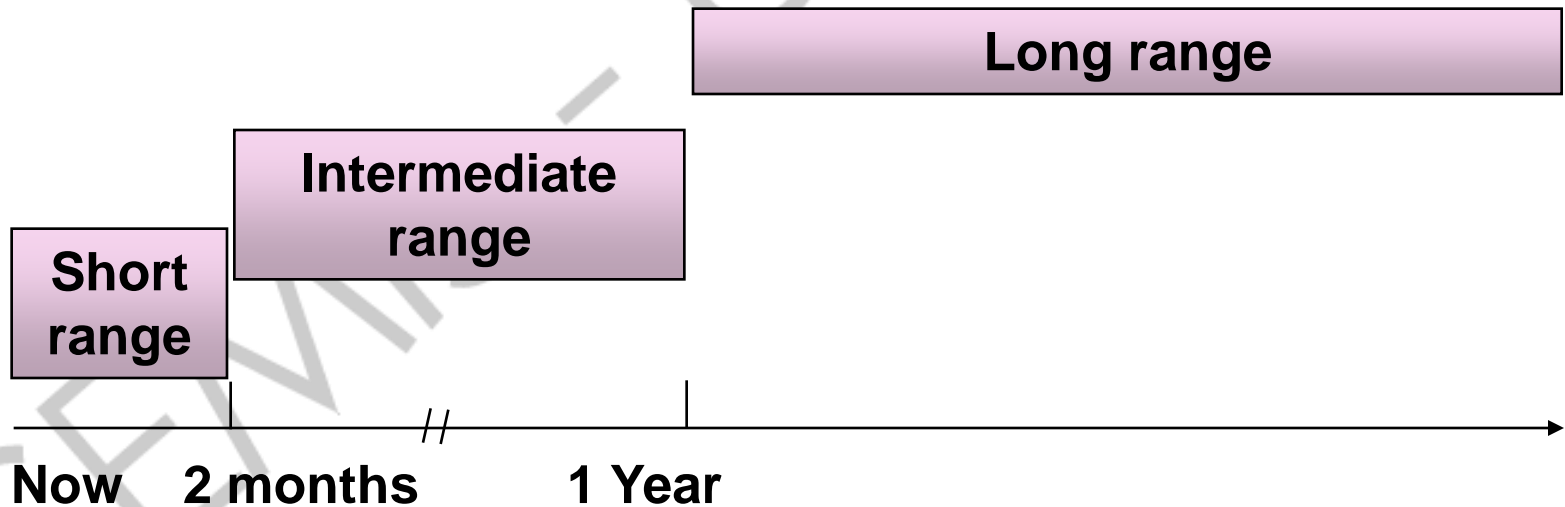
VALUE-ADDED SERVICE CATEGORIES



PLANNING HORIZON

Intermediate-range Capacity Plans: Usually covering 2 to 12 months.

Comes from what is referred to as aggregate planning



Steelmaker DOFASCO Does A Turnaround Through Strategic Refocusing

- ✘ It is no secret that Canadian steelmakers are under pressure. The industry is increasingly facing competition from steelmakers in developing countries such as Brazil, China, and India where labour costs are low. While some other Canadian steel makers struggle, Hamilton based Dofasco, in business since 1912, has turned around its losses from a decade ago through a revised strategy. The company also owns or has partial ownership in facilities in the United States and Mexico.
- ✘ Until the late 1980s, the company competed on price by producing as much steel as possible at the lowest possible prices. However by the early 1990s increased competition resulted in Dofasco not being able to compete profitably. As a result, by 1992 it found itself in debt and losing money.

COMPETITIVE PRIORITIES

Cost: Providing low-cost products. To successfully compete in this niche, a firm must necessarily, therefore, be the low-cost producer. But, as noted earlier, even doing this doesn't always guarantee profitability and success.

Quality: Providing high quality products. Quality can be divided into two categories: product quality and process quality. The level of quality in a product's design will vary as to the particular market that it is aimed to serve.

COMPETITIVE PRIORITIES

Delivery: Providing products quickly. Another market niche considers speed of delivery to be an important determinant in its purchasing decision. Here, the ability of a firm to provide consistent and fast delivery allows it to charge a premium price for its products.

Flexibility: Providing a wide variety of products. flexibility consists of two dimensions, both of which relate directly to how the firm's processes are designed. One element of flexibility is the firm's ability to offer its customers a wide variety of products. The greatest flexibility along this dimension is achieved when every product is customized to meet the specific requirements of each individual customer. This is often referred to as mass customization.

Service: How products are delivered and supported. To obtain an advantage in such a competitive environment, firms are now providing "value-added" service. This is true for firms that provide goods and services.

Why improve operations?

Improving market support

Figure 12.1 Examples of how to review performance and typical improvements to meet alternative order-winners and qualifiers

Order-winner or qualifier	Reviewing current performance	Typical improvements
Price	<ul style="list-style-type: none">• Review actual material, direct labour and overhead costs• Map current processes and identify areas of material and labour waste• Review the mix of operations volumes• Review annual operations volumes within a service/product range• Review production run lengths• Review the contribution per machine hour• Review product pricing	<ul style="list-style-type: none">• Reduce large areas of costs -70-90 per cent of the total cost is usually accounted for by materials and overheads• Reduce material and labour waste• Reduce changeover and set-up times for the manufacturing process• Reallocate products across operations• Focus each operation on a particular market or resource

Why improve operations?

Improving market support

Quality conformance	<ul style="list-style-type: none">Review quality conformance levels for the following areas: services, products, orders, customers and market segments	<ul style="list-style-type: none">Reduce quality conformance errorsBuild quality control into the system rather than checking conformance after the event
Delivery reliability	<ul style="list-style-type: none">Review the delivery performance for services/products, orders, customers and market segmentsAnalyse and compare the delivery lead-times that customers have requested against the actual delivery lead-times that operations suppliesCompare the actual processing with the overall operations lead-time	<ul style="list-style-type: none">Improve the scheduling of activitiesImprove process reliabilityHold inventory at varying stages in the process

SL

Why improve operations?

Improving market support



Delivery speed	<ul style="list-style-type: none">• Analyse and compare the delivery lead-times that customers have requested against the actual delivery lead-times that operations supplies• Compare the actual processing with the overall operations lead-time• Map the actual operations process and identify any areas of material and labour waste	<ul style="list-style-type: none">• Eliminate any waiting time between the steps in the process• Reduce the lead-time of steps in the process• Eliminate wasteful activities
Service or product range	<ul style="list-style-type: none">• Review the capability of the process to meet the service or product range required now and in the future	<ul style="list-style-type: none">• Develop the capability of the system to cope with the service or product range• Develop employee skill levels• Reduce changeover and set-up times



Why improve operations?

Improving market support

Demand fluctuations	<ul style="list-style-type: none">• Assess the ability of the available capacity to respond to known or anticipated changes in demand	<ul style="list-style-type: none">• Invest in capacity or inventory
Speed of new service or product development	<ul style="list-style-type: none">• Map the new service/product development process and identify waste• Determine the length of activities and their dependency on other activities or key resources• Identify activities for which operations has responsibility	<ul style="list-style-type: none">• Eliminate wasteful activities• Increase the capacity of any constraining resources• Reschedule activities so they are completed in parallel (rather than in sequence) with other parts of the process



Why improve operations?

Reducing costs

1. Review where **COSTS** can be reduced:
 - Material, direct and overhead
2. Map activities to identify and eliminate areas of **WASTE**
 - Review and reduce mix of **VOLUMES**
 - Review and increase **PRICE** of services or products
 - Where appropriate
 - Review and **STOP** selling services or products
 - Where appropriate

- By Ms Margaret Kariuki

Contents

1. Job Analysis And Job Design
2. Human Resource Planning
3. Recruitment and Selection
4. Orientation, Training and Development

Job Analysis and Job Design

- The procedure through which you determine the duties of positions in the organization and the characteristics of the people to hire for them.
- A systematic way of determining which employees are expected to perform a particular function or task that must be accomplished.

Definition

- **Job analysis** – a purposeful, systematic process for collecting information on the important work related aspects of a job
- Job Analysis is a process to identify and determine in detail the particular job duties and requirements and the relative importance of these duties for a given job.
- Job Analysis is a process where judgements are made about data collected on a job.

- Job analysis produces information for writing **job descriptions** (a list of what the job entails) and **job specification** (what kind of people to hire for that job)

- Job Analysis is used to show the *relatedness* of employment procedures used by the employer. The procedures supported by job analysis include:
 - Training
 - Recruitment and selection
 - Job evaluation
 - Performance appraisal

Why it is done

- **Job description** –the principal product of a job analysis. It represents a written summary of the job as an identifiable organisation unit
- **Job specification** – a written explanation of the knowledge, skills, abilities, traits and other characteristics (KSAOs) necessary for effective performance on a given job

Definition of terms

- **Tasks** – coordinated and aggregated series of work elements used to produce an output (e.g. a unit of production or service to a client)
- **Position** – consists of the responsibilities and duties performed by an individual. There are as many positions in an organisation as there are employees

Definition of terms (cont..)

- **Job** – group of positions that are similar in their duties , such as accountant, or IT administrator
- **Job family** – groups of two or more job that have similar duties

Definition of terms (cont..)

- *Work activities* - such as cleaning, selling, teaching etc. the list may also include how, why and when the worker performs each activity
- *Human behavior* – like sensing, communicating, deciding , writing.
- Included here may be information regarding job demands such as lifting weights or walking long distances

Types of information collected for job analysis

- *Machine,, tools, equipment and work aids.*
This category includes information regarding tools used, material processed, knowledge dealt with or applied (such as finance or law) and services rendered (such as counseling or repairing)
- *Performance standards* - in terms of quantity and quality levels of each job duty

- *Job context* - such matters as physical working conditions, work schedule, and the organizational and social working context – for example the number of people with whom the employee would normally interact
- *Human requirements* – included information such as job related knowledge or skills (education, training, work experience) and required personal attributes (aptitude, physical characteristics, personality, interest)

- Job analysis provides answers to questions such as:
 - How much time is taken to complete important tasks
 - Which tasks are grouped together and hence considered a job
 - How can a job be designed or structured so that the employee's performance can be enhanced

Questions answered by job analysis

- What kind of behaviours are needed to perform the job
- What kind of person (in terms of traits and experience) is best suited for the job
- How can the information acquired by a job analysis be used in development of HRM programmes

Questions answered by job analysis (cont...)

- Step 1:
- **Examine the total organization and the fit of each job**
- Provides a broad view of how each job fits into the total fabric of the organization
- Organizational chart and process chart are used to complete step 1
- Step 2
- **Determine how the job analysis information will be used**
- Encourages those involved to determine how the job analysis and design information will be used – will it be used for job description

Steps in job analysis

- Step 3
- **Select jobs to be analyzed.** These would be representative job positions especially if there are too many jobs to be analyzed
- Step 4
- **Collect data by using acceptable job analysis techniques.**
- The techniques are used to collect data on the characteristics of the job, the required behaviours and the characteristic an employee needs to perform the job

Steps (cont...)

- Step 5: prepare job descriptions
- Step 6: prepare job specification
- Step 7: Use the information in step 1 – 6 for job design, planning, recruitment, selection and training, performance evaluation, compensation and benefits etc

Steps (cont..)

- *1. To validate* or assess the accuracy of organizational selection procedures
- *2. Recruitment and selection*:
 - Job analysis information helps recruiters seek and find the right person for the organisation.
 - And to hire the right person, the selection test must assess the most critical skills and abilities needed to perform a job. This information comes from a job analysis

The uses of job analysis

- *3. Training and career development:*
 - Knowing the skills necessary for jobs is essential to building effective training programmes.
 - Moreover, helping people to move efficiently from one career stage to another can only be accomplished with information from job analysis

The uses of job analysis (cont..)

- *4. Compensation:*
- Compensation is usually tied to the duties and responsibilities of a job.
- Thus, proper compensation demands accurate assessment of what various jobs entails
- *5. Performance appraisal*
- *6. Job evaluation*

The uses of job analysis (cont..)

- **7. Strategic planning**

- More and more, managers are beginning to realize that job analysis is another important tool in an organization's overall strategic planning effort.
- Effective job analysis can help organizations to change, eliminate or otherwise restructure work or work flow process to meet the changing demands of uncertain environments

The uses of job analysis (cont..)

- In conclusion, it should be noted that job analysis covers the entire domain of HRM as it would be difficult to be effective in hiring, training, appraising, compensation or utilize HR without the information derived from job analysis

The uses of job analysis (cont..)

- If a organisation has only an occasional need for job analysis information, it may hire a temporary job analysts from outside
- Other organisations will have job analyst experts on full time
- Others will use supervisors, job incumbents, or some combination these to collect job analysis information

Who should conduct job analysis

- Each of these choices has strengths and weaknesses
- Use of job incumbent - strengths
- Job incumbents are a good source of information about what work is actually being done rather than what work is supposed to be done
- Also involving incumbents in the job analysis process might increase their acceptance of any work changes stemming from the result of the analysis

**Who should conduct job analysis
(cont...)**

- Use of job incumbent –
- Job analysis should describe the work activities the work of a job independent of any personal attributes of a given job incumbent.
- Because incumbents tend to exaggerate the responsibilities and importance of their work, this objectivity might be difficult to achieve when incumbents conduct the job analysis

**Who should conduct job analysis
(cont...)**

- The choice of who should analyse a job depends therefore on many factors:
- Location
- Complexity of the job
- How receptive incumbent might be to external analysis
- The intents purpose of the result of the job analysis

**Who should conduct job analysis
(cont...)**

- There are four basic methods of data collection which can be used separately or a combination:
 - Observation
 - Interview
 - Questionnaire
 - Job incumbent diaries or logs

Methods of data collection

- **Direct observation** is used for jobs that require manual, standards, and shot-job cycle activities e.g. job of a assembly line work, a filing clerks,
- The job analysis observes a representative sample of individuals performing the jobs

observation

- Observation method is not appropriate where the job involves significant mental activity such as work of a research scientist, lawyer, teacher etc
- The observation method requires that the job analyst be trained to observe relevant job behaviours
- He/she must also keep out of the way so that work must be performed

Limitations of observation method

- Can be conducted with a single job incumbent, or with a group of individuals or with a supervisor who is knowledgeable about the job
- Involves face to face talk with the job incumbents
- Must be structured in such a way that answers from different individuals can be compared

interviews

- Its relatively simple and quick way of collecting information including information that might never appear in written form
- A skilled interviewer can unearth important activities that occur only occasionally, or informal contacts that wouldn't be obvious from the organizational chart
- The interview also provide an opportunity to explain the need for and functions of the job
- The employee might also vent frustration that might otherwise go unnoticed by management

Advantages of interview

- However, it should be noted that interview guides are difficult to standardize – different interviewers may ask different questions and the same interviewer might unintentionally ask different questions of different respondents
- There is also possibility that the information provided by the respondents will be unintentionally distorted by the interviewer.
- Finally the cost of interviewing can be very high

Limitations of interview

- What is the job being performed
- What are the major duties of your position, what exactly do you do
- What physical location do you work in
- What education, experience, skills and (where applicable) certification and licensing requirements
- In what activities do you participate
- What are the job responsibilities and duties

Typical questions in an interview

- What are the basic accountabilities or performance standard that typify your work
- What are your responsibilities? What are the environmental and working conditions involved
- What are the jobs physical demands ? The emotional and mental demands
- What are the health and safety condition
- Are you exposed to any hazards or unusual working conditions

**Typical questions in an interview
(cont..)**

- This is usually the least costly method of collecting information
- It is an effective way to collect a large amount of information in a short period of time
- The questionnaire includes:
 - Specific questions about the job
 - Job requirements
 - Working conditions
 - Equipment

Questionnaire method

- A less structures, more open-ended approach would be to ask job incumbents to describe their jobs in their own terms
- This open-ended format would permit job incumbent to use their own words and ideas to describe the job

Questionnaire method (cont..)

- **Keep it as short as possible** – people do not generally like to complete forms
- **Explain** what the questionnaire is being used for – people want to know when it must be completed. Employees want to know why the questions were being asked and how their response will be used
- **Keep it simple** – do not try to impress people with technical language. Use the simplest languages to make a point or ask a question
- **Test** the questionnaire before using it – in order to improve the questionnaire, ask some job incumbents to complete it and to comment on its features. The test will permit the analyst to modify the format before using the questionnaire in final form

**Hints that will make the
questionnaire easier to use**

- The diary or log is a record by job incumbent of job duties. It includes:
 - Frequency of the duties
 - When the duties were accomplished
- This technique requires the job incumbent to keep a diary or log
- Unfortunately, most individuals are not disciplined enough to keep such a log a diary.

Job incumbent dairy or log

- If a diary is kept up to date, it can provide good information about a job
- Comparison on a daily, weekly or monthly basis can be made
- This permits an examination of the routineness or nonroutineness of the job duties
- A daily log is useful when attempting to analyse jobs that are difficult to observe such as those performed by engineers, senior executives etc

Job incumbent diary or log (cont..)

- FJA identifies performance standards and training requirements.
- Functional job analysis rates the job not just on data, people, and things, but also on another dimensions: worker instructions, reasoning, mathematics, language.

Other methods – Functional Job analysis (FJA

- Functional Job Analysis includes scales (numbers) that measure:
- **Worker-instruction** scale.
- Scales that measure **reasoning, mathematics, language.**
- Worker-function scales: measure % of time spent with **data, people and things**
 - **Total 7 scales**

**Contents of FJA method /
technique**

- Any or a combination - a ***multimethod job analysis approach***
- It is recommended a combination because each of the method has its strengths and can elicit more of some specific information
- The choice of method may also be determined by circumstances such as the purpose of the job analysis, and time and budgetary constraints

Which method to use

- A job description, is a written description of what the job entails
- Written statement of what the worker actually does, how he does or she does it, and what the working conditions are
- job description clarifies work functions and reporting relationships, helping employees understand their jobs.
- Job descriptions aid in maintaining a consistent salary structure.
- Performance evaluations may be based on job descriptions

Job description

- Job title/job identification
- Job summary
- Relationships
- Authority of the incumbent
- Standards of performance
- Environmental conditions

Information contained in a JD

- Job title/job identification -Includes:
 - Job title
 - location of the job in terms of department, division or section.
 - May also include immediate supervisor's title
 - Information regarding salary and /or pay scale
 - grade/level of the job

Job identification

- Brief one or two sentence statements describing the purpose of the job and what outputs are expected from the incumbents
- Describes general nature of the job and includes only the major functions of the job or activities e.g. the marketing managers job is to plan, direct and coordinate the marketing

Job summary

- Shows job holders relationship with others inside and outside the company. Includes:
 - reporting to
 - Supervises
 - Works with
 - Outside the company

Relationships

- List each of the job major responsibilities separately, and describes it in a few sentences
- Responsibilities and duties , includes:
 - description of the job duties, responsibilities, and behaviour performed on the job.
 - Describe the social interaction associated with the work (for example, size of the work group, amount of dependence in the work)
 - This section should also define the limits of the jobholders authority, including his or her decision making authority, direct supervision of other personnel and budgetary limits.
- Includes general statements like “perform other assignments as required” purpose is to give supervisor more flexibility in assigning duties.

Responsibilities and duties

- List the standard the employee is expected to achieve under each of the job descriptions main duties and responsibilities .g. accurately post accounts payables, meet daily production targets etc

Standard of performance

- **Environment/conditions** – description of the working conditions of the job, the location an environment such as hazards and noise levels

Environmental conditions

- This evolves from the JD
- It is a statement of employee characteristics and qualifications required for satisfactory performance of defined duties and tasks comprising a specific job or function.
- It addresses the question “what personal traits and experience are needed to perform the job effectively”
- the JS is specifically useful in offering guidance for recruitment and selection e.g. the job for HR manager would require a university degree, six year of experience in HRM

Job specification

- **Personal characteristics** such as education, job experience, age, sex, and extra co-curricular activities.
 - **Physical characteristics** such as height, weight, chest, vision, hearing, health, voice poise, and hand and foot coordination, (for specific positions only).
- Mental characteristics** such as general intelligence, memory, judgment, foresight, ability to concentrate, etc.
- Social and psychological characteristics** such as emotional ability, flexibility, manners, drive, conversational ability, interpersonal ability, attitude, values, creativity etc.

Components of a Job Specification

- Various contents of a job specification can be prescribed in three terms:
 - Essential qualities which a person must possess;
 - Desirable qualities which a person may possess; and
 - Contra-indicators which are likely to become a handicap to successful job performance.

Human resource Planning

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HR planning definition

- Human Resource planning is the process by which an organisation ensures that:
 - It has the right number and kinds of people,
 - At the right places,
 - At the right time,
 - Capable of effectively and efficiently completing those tasks that will help the organisation achieve its overall strategic objectives.

Definition

- It is the process of assessing the future supply of and demand for human resources.
- It also provides mechanisms to eliminate any gaps that may exist between supply and demand
- It is a process of determining what positions in the firm will have to be filled and when

- Human Resource planning translates the organization's overall goal into the number and types of workers needed to meet those goals.
- Without clear-cut planning, estimation of an organization's human resource need is reduced to mere guesswork.

Definition (cont..)

- Thus, HR planning determines the number and types of employees to be recruited into the organisation or phased out of it

Factors affecting planning

1. Organisation policy on recruitment, retirement, workforce mix etc
2. organizational values and strategies
 - values - If it values longevity of employees, then the HR plan might adopt that a strategy to recruit and promote from within.
 - Strategy - if an organisation is pursuing a diversification strategy, then the HR plan should ensure that it is prepared with staff that can help the firm achieve its strategy

3. Changing demographic - more young, more old, more educated

If the markets of labour changes to more young, more old, more women or more educated people etc, then the job descriptions, compensations strategies and general way of working might have to change to suit these groups

4. Government policy. Requirement for gender balance, disability employment, mandatory retirement age

Factors affecting planning (Cont..)

- 5. The type of people employed and the task they perform.
 - An organization may not need to plan very far in advance for unskilled labor, since they will usually be in abundant supply.
 - Certain high skills job require planning activities that project a year or two into the future. Planning for executive replacement may need 10 years ahead

Process of HR planning

- Review your current organizational strategic plan
- Review the current human resources situation
- Forecast on the future HR needs (supply and demands)
- Planning on meeting HR needs
- Implement the plan – recruit, select, training , downsizing

Reviewing the current strategic plan

- HR planning goes hand in hand with the organizational *strategic planning*
- *Strategic planning* refers to the organizational decision about how it wants to accomplish its mission and strategies
- The first stage of HR planning is the point at which HRM and strategic planning initially interact.
- What is the future direction of the company and what are the implications of HR
- Future direction in terms of technology, markets, organizational structures, etc

HR planning and SP (cont..)

- the strategic planning takes into consideration the following:
 - Technological forecast
 - economic forecast
 - market forecast
 - organizational planning
 - investment planning
 - annual operational plans

A model for HR planning process (cont..)

- The role of HR is to ensure that the implementation of the strategic is successful, by putting in place the right HR
- The acknowledgement that HR policies and practices have a critical linkage with the overall organizations strategy is generally termed *strategic human resources management (SHRM)*

- Without an effective HR plan to support the recruitment and selection function in the organisation, it would be impossible to move fast enough to stay competitive

Review the current human Resource situation

- This is done by studying personnel records
- In studying personnel records one need to know the following:
 - How many do we have in what category?
Quality and quantity
 - Who is leaving the organization and when (project turnover as result of resignation and termination)

Forecasting Future Human Resource Needs

- I. Forecast Staff demand
- II. Forecast Staff supply

Forecasting demand

- How many, what levels when
- The demand is closely tied to the strategic direction that the organisation has decided to take. – are we engaged in reengineering that will shrink the workforce in the coming years

Forecasting demand (cont...)

- Consider:
 - major customer requirements and hence forecast on revenue and seasonal fluctuations
 - Projected staff turnover (as a result of resignation or termination or retirement)
 - Strategic decisions to upgrade the quality of products or services or enter new markets
 - Technological and other changes resulting in increased productivity
 - Financial resources available to you
 - Staff movements and transfers

Techniques of forecasting demand

- Experts estimates
- Trend projections
- Statistical modeling
- Unit demand forecasting
 - All these require close collaboration between HR department and line management

Experts estimates

- Expert(s) provide the organisation with demand estimates based on experience, guesses, intuition, and subjective assessment of available economic and labour force indicators
- This can be done an individual providing estimates, which are then revised based on estimates of other individuals estimates. *This is called Delphi technique*
- Or individuals develop estimates, followed by a group brainstorming sessions in the hope of generating one group decisions. This is called *nominal group technique (NGT)*

Trend projections

- This involves developing a forecast based on past relationship between a factor related to employment and employment itself
- E.g.. for many businesses, sales levels are related to employment needs. The planner can develop a table showing past relationship between sales and employment

Modeling and multiple-predictive technique

- This is using sophisticated forecasting and modeling techniques. This method uses many factors such as sales, GDP, incomes etc and develop mathematical models for forecasting

Unit demand forecasting

- The unit (which can be an entire department, a project team or some other group of employees) demand is forecast and the sum total of these units becomes the employment forecast.
- The unit manager analysis person by person, job –by-job needs in the present as well as in the future.

- By analyzing the present and future requirements of the job and the skills of the incumbent, this method focuses on the quality of workers

Forecasting supply

Internal supply.

- The main task is to determine which current employees might be qualified for the projected openings
- This determines how many, and what kind of employees are currently available in terms of skills and training necessary for the future.
- The major tool used to assess the current supply of employees is the *skills inventory*
- In some organisations, there will be a separate inventory just for managers called a *management inventory*

- Both of these serve the same purpose: to note what kind of skills, abilities, experiences, and training the employees currently have.
- By keeping track of these, the organisation can quickly determine whether a particular skill is available and when it will be needed
- Skills inventory are also useful in career planning, management development and related activities

Contents of a skills inventory

- Once a decision has been made to create a skills inventory, the HR manager must determine what information will be contained in the system.
- The only data available to the organisation for later use will be whatever has been designed into the system

Contents of a skills inventory (cont..)

- The list of data that can be coded into the skills inventories is endless and it must be tailored to the needs of each organisation.
- Some of the most common items include:
 - Name and Employees number
 - Present location
 - Date of birth, date of employment

Contents of a skills inventory (cont..)

- Job classification
- Specific skills and knowledge
- Education and field of education(formal education and course taken since leaving school)
- Knowledge of a foreign language
- Professional qualification
- Publication, licenses, patents, hobbies,
- A supervisors evaluation of the employees capabilities

Contents of a skills inventory (cont..)

- Salary range,
- Items often omitted, but become increasingly important
- Employees stated career goals and objectives, including geographical preferences and intended retirement date

Components of a skills inventory

- Components of a skills inventory are therefore as follows:
 1. Data summarizing the employees past:
 2. Data summarizing status of present skills
 3. Data that focus on the future

Data summarizing the employees past

- a) Title and brief job description highlighting positions held in the last two to five years either in the organisation or previous organisations
- b) Critical skills needed or developed in these positions – manual, cognitive, creative

Data summarizing the employees past (cont..)

- C) Educational achievements – high school, job relevant classes, college (major minor)
- D) significant special project accomplished during the last three years (within this organisation or the previous organisation)

Data summarizing the status of the present skills

- A) skill related highlights last three performance appraisals
- B) Employee perception of what is done well on present job e.g. skill competencies, perception of how skills could be improved
- C) Employees supervisor perception of the same

3. Data that focus on the future

- A) personal career goals – one year, three years, identify specific positions and aspiration. Avoid global generalities like “higher up”
- B) view of the individuals present supervisors as to what he or she could be prepared to become. List specific position
- C) specify training and development efforts that the individual is motivated to undertake – on the job, off the job, classroom or experiential

- The above three components are just a sample and some organisations may have a skill inventory cataloguing different job classification

Maintaining the skills inventory

- The skill inventory is maintained by continuous gathering, handling and updating data. Decisions to be made include:
- **Method of data gathering:** The two principle method of gathering data are interviewing and questionnaire
- **When to update:** Updating must be planned – e.g. annual update, or where changes are frequent, monthly update
- **Manual or computerizes:** A decision will also have to be made on whether to store data manually or to computerize it

Forecasting external supply

- From the labour market
- Consider: economic indicators – competition and wage levels, cost of living, education levels, unemployment levels
- Forecast on the availability of potential job candidates in specific occupation e.g. IT administrator, HR personnel, is there an under or over supply.

Action decisions in HR planning

- After HR planning system has analyzed both the supply and demand for future workers, these two forecasts are compared to determine what if any actions should be taken.
- Whenever there is a discrepancy between the two estimates, organisations need to choose a course of action to eliminate the gaps

Action decisions on a shortage of employees

- When the employment specialist find that the supply is less than the demand, several possible are open to the organisation.
- 1) if the shortage is small and the employees are willing to work overtime, it can be filled with present employees
- 2) If there is a shortage of highly skilled employees, training and promotion of present employees, together with recruitment of less skilled employees are possibilities.

Action decisions on a shortage of employees (cont..)

- Other decision can also include:
- recalling employees who were laid off
- Use of part time workers, subcontracting,

Action decisions in surplus conditions

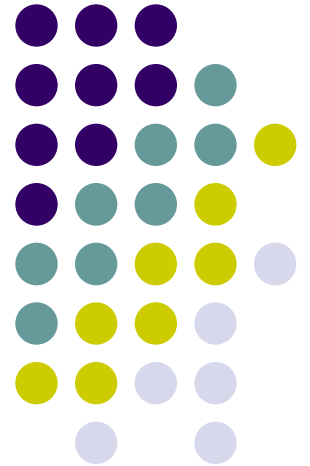
- When supply is more than demand solutions include:
- attrition – not replacing those who leave
- Early retirements to accelerate attrition (this must be carefully planned, so that it does not lead to acute shortage of skill that will negatively affect companies ability to compete)
- Demotions Layoffs
- Termination
- Transfers
-

- As an approach to dealing with a surplus, most organisations avoid lay offs and rely more on attrition, early retirements and creation of work etc

Plan on how to meet Human Resource need

- I. Training and development
- II. Recruitment and selection
- III. Retirement
- IV. Rightsizing

RECRUITMENT AND SELECTION



SEMS - UOJ

Reported misconceptions about R and S



- First, research is not well disseminated and remains buried in jargon laden pages of academic journals , rather than translated into “something useful” and made accessible to HR executives

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- Second, research is focused on the situation in the abstract and seldom takes into account the many contextual factors (e.g., budget, time constraints) an HR practitioner must juggle in making decisions about what tools and strategies to employ.



- Third, many HR professionals in staffing functions and particularly those in tight labor markets face constant pressure to deliver qualified candidates quickly and lack the time to create new recruiting and selection programs that take into account current research findings.



- Fourth, some stakeholders' perceptions and goals for hiring are not compatible with the research making it difficult for the HR professional to incorporate the research findings into a hiring program

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- Fifth, many HR professionals find myriad legal requirements confusing. Consequently, they avoid testing and other systematic approaches to selection despite the research because they believe erroneously that testing will create legal problems rather than solve them.



Meaning of Recruitment

- According to Edwin Flippo: “Recruitment is the process of searching the candidates for employment and stimulating them to apply for jobs in the organisation “
- Recruitment is the activity that links the employers and the job seekers



Other definitions

- A process of finding and attracting capable applicants for employment
 - process begins when new recruits are sought and end when their applications are submitted.
 - The result is a pool of applicant form which new employees are selected



Other definition cont..

- It is a process to discover sources of manpower to meet the requirement of staffing schedule and to employ effective measures of attracting that manpower in adequate numbers to facilitate effective selection of an efficient workforce



Other definitions cont...

- Recruitment is the first step in filling a vacancy. Includes:
 - Examine the vacancy
 - Considering the source of suitable candidates
 - Making contacts with the candidates
 - Attracting applications from them



Other definitions cont...

- Recruitment is the function preceding the selection which helps create a pool of prospective employees for the organization so that the management can select the right candidates from this pool (to expedite the selection process



Recruitment needs

- Are of three types
 - **Planned** – arising from changes in organizational structure, policy of retirement etc
 - **Anticipated** – movement in personnel which an organisation can predict by studying trends in internal and external environment
 - **Unexpected** – resignation, death, accident, illness

Purpose and Importance of effective recruitment



- The increasing unemployment means that the labour market is large, hence the need to ensure that you attract the right candidates for the jobs
- High turnover for some occupations are another problem for recruiting
- Finding the right inducements for attracting and hiring employees can be a problem also



purpose

- Attract and encourage more and more candidates to apply in the organisation
- Create a talent pool of candidates to enable the selection of the best candidates for the organisation
- Determine present and future requirements of the organisation in conjunction with its personnel planning and job analysis activities as



- Minimize unwarranted cost of selection
- Help increase the success rate of selection process by decreasing the number visibly under qualified or overqualified job applicants
- Help reduce probability that job applicants once recruited and selected will leave the organization only after a short period of time
- Meet the organisation legal and social obligation regarding composition of workforce



- Increase organization and individual effectiveness of various recruitment techniques and sources for all types of applicants

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Recruitment process

- Identifying the vacancy : - post to be filled, number of persons, duties to be performed, qualifications required
- Preparing the JD and JS
- Locating and developing the sources of required number and type of employees
- Short listing



Factors affecting recruitment

- Internal factors
 - Recruitment policy
 - HR planning and strategy
 - Size of the firm
 - Cost of recruitment
 - Growth and expansion



Factors affecting recruitment

- External factors
 - Supply and demand
 - Labour market
 - Image/goodwill
 - Political-social-legal environment
 - Unemployment rates
 - Competitors

Sources of recruitment: internal and external



Internal:

- Seeks to fill positions from among the rank of those currently employed
- Best suitable in succession planning – the process of ensuring a suitable supply of successors for current and future senior or key jobs



Advantages:

1. It is less costly than external recruiting
2. Organisations have a better knowledge of internal applicants skills and abilities than that which can be acquired of candidates in an external recruiting effort



3. Through performance appraisal and other sources of information about current personnel, decision makers typically will have much more extensive knowledge on internal candidates and thus make more valid selection decisions
4. An organisation policy of promotion from within can enhance organizational commitment and job satisfaction, leading to lower employee turnover and productivity
5. Best used for succession planning



Disadvantages:

1. If the organisation has decided to change its business strategy, entrenched managers are problem not the best “change masters” since the internal recruitment approach simply propagate the old way of doing things
2. Complaints of unit poaching good employees from another unit
3. Politics have a greater impact on internal recruitment. Personal biased decisions towards specific candidates not necessarily based on performance or job requirements



4. Employees who apply for jobs and do not get them may become discontented,; telling unsuccessful applicants why they were rejected and what remedial action might take to be more successful in future is thus crucial
5. Although many times managers post job opening and interviews to all candidates, the manager often knows ahead of time exactly whom he or she wants to hire . Requiring the person to interview a stream of unsuspecting candidates can be a waste of time for all concerned



6. Groups are sometimes not as satisfied when their new boss is appointed from within their own ranks as when he/she is a newcomer. It may be difficult for the insider to shake off the reputation of being “one of the gang”
7. Inbreeding is another potential drawback. When all managers come up through the ranks, they may have a tendency to maintain the status quo, when a new direction is what is required. Balancing the benefit of morale and loyalty with the possible inbreeding problem can be a challenge

Sources of internal recruitment



- **Job posting/advertising**
- The most efficient way to do it is to have a job-posting system where announcement for positions is made available to all employees through newsletters, bulletin boards and so on.
- When properly done, job posting can substantially improve quality of job placement that are made within the organisations
- **Personnel records**
- Another way is to examine personnel records which may reveal employees who are working in job below their education or skill levels, or/and have potential for further training or who already have the right background for the opening



External recruitment

- Can be important when:
 - A firm cannot get all the employees they need from the current staff
 - When the firm wants to inject a new perspective into running the organisation

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EXTERNAL SOURCES

- External sources
 - Advertising
 - Colleges
 - Agency Search and Selection
 - Head Hunting
 - Open Evening
 - Referrals and walk –ins
 - Recruitment on the internet



Advertising

- For this to be successful the firm must address two issues:
- The advertising media
- The advert construction

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Advertising media

- The selection to the media depends on the positions which the firm is recruiting for
- Local newspapers – for blue collar jobs and jobs whose labour is in plenty supply
- Specialized jobs will be adverted in trade and professional journals like the economists , etc
- Jobs with an international focus will be advertised in international dailies or magazines

Constructing an Ad



- Should have the following four point guide (AIDA):
 - Attention – must attract attention to the Ad or readers may just miss it or ignore it
 - Interest – you can create interest by the nature of the job itself, or with lines such as “will thrive on challenging work”, or use other aspects such as location
 - Desire – by spotlighting the job interest factors with words such as *travel* or *challenge*
 - Action - Make sure the ad prompts action with statements such as “call today”

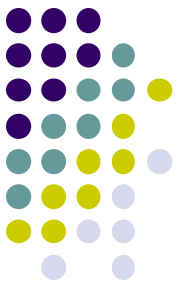


- Should contain the following information:
 - Job content (primary task and responsibilities)
 - A realistic description of the work conditions
 - The location of the job
 - The compensation including fringe benefits
 - Job specification (e.g. education and experience)
 - To whom one should apply



Employment agencies

- Agencies that charge employees or employers for the placement services
- Major functions:
- To increase the pool of possible applicants and to do preliminary screening



Why turn to employment agencies

- Your firm doesn't have its own HR department and is not geared to doing recruitment and screening
- Your firm has found it difficult in the past to generate a pool of qualified applicants
- You must fill a particular opening quickly
- You want to reach currently employed individuals who might feel more comfortable dealing with agencies than with competing companies
- You want to cut down on time you are devoting to interviewing

Executive recruiters (headhunters)



- Are special employment agencies retained by employers to seek out top management talent for their clients
- Usually for crucial executive and technical positions
- Executive recruiters are becoming more and more specialized to recruit for specific functions or industries

advantages of using head hunters



- The recruiters may have many contacts and are especially experts and skilled at contacting qualified, currently employed candidates who aren't actively looking for a change in jobs
- They can also keep the firm's name confidential until late into the search processes
- The recruiters save top management's time of advertising and screening



Pitfalls of headhunting

- As an employer, you must explain completely what sort of candidate is required and why,
- Some recruiters are also sales people than professionals – they may be more interested in persuading you to hire a candidate than finding one who will really do the job
- Recruiters also claim that what their clients say they want is often not accurate, therefore be prepared for



College recruiting

- Sending an employers representative to college campuses to prescreen applicants and create an applicant pool from that college graduating class is an important source of management trainees, promotable candidates, and professional and technical employees



- Problems with on campus recruiting:
- Its expensive and time consuming – schedules must be set well in advance, company brochures printed, record of interview kept, and much time spent on campus
- Some recruiters are ineffective and/or show little interest in the candidates and act as superiors



Referrals and walk-ins

- The firm posts announcements of openings and request for referral's in its bulleting and on its wall boards and intranet.
- Pros:
 - Current employees can and usually provide accurate information about the job applicants they are referring, especially since their are putting their own reputation at risk
 - The new employee may come with more realistic picture of what working in the firm is like after speaking with friends there
 - Cons: employees bringing their friends who are not necessity qualified



Recruiting on the internet

- Firms post job description and vacancies on their websites

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Developing and using application forms



- Once you have a pool of applicants, the selection process can begin, and the application form is usually the first step in this process
- A filled application form provides four types of information:
 1. You can make judgment on substantive matters, such as whether the applicant has the education and experience to do the job.
 2. You can draw conclusion about the applicants previous progress and growth, a trait that is especially important for management candidates



3. You can draw tentative conclusion regarding the applicants stability on previous work record (here, however, be careful not to assume that an unusual number of job changes necessarily reflects on the applicants stability)
4. You may be able to use the data in the application form to predict which candidates will succeed on the job and which will not



Employee selection

- With a pool of applicants, the next step is to select the best candidate for the job.
- This means whittling down the application pool by using the screening tools such as test, assessment centers, background and reference checks



Why careful selection is important

- Selecting the right employee is important for three main reasons:
- 1. Performance:
 - Your own performance always depends in part on your subordinates.
 - Employees with the right skills and attributes will do a better job for you and the company.
 - Employees without these skills or who are uncompromising or obstructionist won't perform effectively and your own performance and that of the firm will suffer.
 - The time to screen out undesirables is before they are in the door, not after



2. It is costly to recruit and hire employees in terms of interviewing time, reference checking, traveling etc
3. Legal implication of incompetent hiring can be costly and lead to court redress. If you hire a criminal who swindles customers, you will be liable



Basic tests for selection

- For effective recruiting, therefore, the selection test must be **valid** and **reliable**
- Validity:
 - The test should measure what is supposed to measure. The evidence that is being tested should be job related, in other words, the performance on the test is a valid predictor of subsequent performance on the job



- There are two ways to demonstrate test validity: **criterion validity** and **content validity**
 - Criterion validity – shows that those who do well in the test also do well on the job and vice versa
 - Content validity – show that the test constitutes a fair sample of the content of the job 11



Reliability

- Reliability refers to its consistency.
- It is “the consistency of scores obtained by the same person when retested with the identical test or with an equivalent form of test”
- If a person score 90% on Monday, then they should score the same on Tuesday for the same test



Types of tests

- We can classify test according to whether they measure:
 - Cognitive (mental) abilities.
 - Or psychomotor (motor and physical)
 - Personality
 - Interest or achievements



Test for cognitive abilities

- These includes:
 - Test of general reasoning ability (intelligence)
 - Test of specific mental abilities like memory and reasoning, verbal comprehension, numerical ability
- (these are normally referred to as aptitude tests)



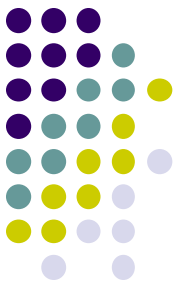
- Test for motor and physical abilities
 - These includes test such as manual dexterity, reaction time, speed of hands, arms, mechanical ability, weight lifting, body coordination etc
- Measuring personality and interest
 - These includes persons motivation and interpersonal skills , attitudes, temperaments etc
 - It will measure basic aspects of a applicants personality such as introversion, stability and motivation. These test are done in a projective manner – for example being presented with a picture and asked what you see, picking two statements from one etc



Achievement tests

- Measure what a person has learned
- Measure your “job knowledge” in areas like marketing, human resources. E.g. giving people a problem in human resources to solve

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Management assessment centre

- Is a 2 to 3 days simulation in which 10 – 12 candidates perform realistic tasks (like making presentations, meetings, case study analysis – each under watchful eye of experts. Also included are interviews, leadership group discussions, management games,



Other selection techniques

- Background investigation and reference check
- Polygraph (lie detector) and honesty testing
- physical examination
- Substance abuse screening

Background investigation and reference checks



- Purpose is to verifying job applicants background information and references:
- These include making telephone enquiries, credit rating, use of reference letters
- Commonly verified data include legal eligibility for employment, dates of prior employment, education and identification (dates of birth, address to confirm identity)

Reasons to conduct background check



- Two main reasons to conduct employment background investigation and/or reference check:
 - To verify fact information previously provided by the applicants
 - To uncover damaging information such as criminal records

Physical/medical examination



- Takes place once the person is hired or sometimes after the person is hired
- Reasons:
 - To verify that the applicant meets the physical requirements for the
 - Discover any medical limitations you should take into account in placing the applicants
 - To establish a record and baseline of the applicants health for future insurance or compensation claims
 - By identifying health problems, the examination can reduce absenteeism and accidents and, of course determine communicable diseases that may be unknown to the applicant



Interviewing candidates

- An interview is a procedure designed to obtain information from a person through oral responses to oral enquires. On the basis of these responses the interviewer is able to predict future job performance
- Interview is by far the most widely used personnel selection method



Types of interviews

- We can classify selection interviews according to:
 - How they are structured - directive or non directive
 - content – type of questions they contain
 - How the firm administers the interview

Unstructured or non directive



- There is generally no set format to follow so the interview can take various direction
- Lack of structures allow the interviewer to ask follow up questions and pursue points of interest as they develop

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Structured or directive interviews



- The questions and acceptable responses are specified in advance and the responses rated for appropriateness of content
- All interviewers generally ask all applicants the same questions, and hence:
 - Tend to be more reliable and valid
 - It increases consistency across candidates
 - Enhances job relatedness
 - Reduces overall subjectivity (and thus the potential for bias)
 - May enhance ability to withstand legal challenges
- On the other hand structured interviews do not provide opportunity to pursue points of interest as they develop

Interview content – type of questions



- These could be **situational interview questions** - asking candidates how they would behave in a given **hypothetical** situation and evaluating the applicant based on the choice made
- **Behavior** interview questions asks interviewees to describe how they would react to an **actual** situation in the past



- **Job related** interviews – the interviewer tries to deduce what the applicant on the job performance will be base on his or her answers to questions about past behavior. The question here do not revolve around hypothetical questions but ask job related questions e.g. what does human resources recruitment and selection involve



- **Stress interview** – seeks to make the applicant uncomfortable with occasionally rude questions
- Aims is supposedly to spot sensitive applicants and those with low or high level of stress tolerance
- Stress interviews may help unearth hypertensive applicants who might overreact to mild criticism with anger and abuse



Administering interviews

- **Personal interviews (one on one)** - two people meet alone and one interviews the other by seeking oral responses to oral inquiries
- **Sequential** – several persons interview the applicant in sequence, before a decision is made. This can be structured or unstructured
- **Panel** – a group of interviewers question the candidate. This may have advantage over the others because in sequential candidates may cover the same ground over and over again with each interviewer. But panel format lets the interviewers ask follow up questions based on the candidates answer. This may elicit more responses



- **Computerized interview** - in this case a job candidate's oral and/or visual responses are obtained in response to computerized oral or visual or written questions and/situation
- A candidate is presented with a series of specific questions regarding his/her background,, experience, education, skills, knowledge and work attitudes that relate to the job for which the person has applied
- The questions are presented in a multiple choice and questions come in rapid sequence
- After the computerized interview there is usually a one on one

What can undermine an interviews usefulness –pitfalls/errors



- **First impression** – which one gets from the interviewees application form and personal appearance
- **Misunderstanding of the job** - interviewers who do not know precisely what the job entails and what sort of candidate is best suited for it usually make their decisions based on incorrect stereotype of what a good applicant is



- **Candidates-order (contrast) error and pressure to hire** - The order in which you see applicants affect how you rate them. After first evaluating unfavorable candidates, an average candidate can score quite highly
- Pressure to hire accentuate problems like the error or contrast



- **Non verbal behavior and impressions management** - - eye contact, energy levels , low voice etc can influence the interviewers decision
- Body language, smile, posture may interfere with the interviewers judgment
- **Effect on personal characteristics stereotyping :**
- Involves categorizing groups according to general traits then attributing those traits to a particular individual once the group membership is known
- attractiveness, gender, race - in general, individuals ascribe more favorable traits and more successful life outcomes to attractive people
- Some see men or women as more suitable or a certain race as more suitable



- **Interviewer's behavior** - some interviewers talk so much that the applicant have no time to answer questions. On the other extreme, some interviewers let the applicant dominate the interview and so don't ask questions. Neither is good situation
- Others play the role of a judge or psychologist

Designing and conducting an effective interview – steps



The structured situational interview –procedure:

1. Job analysis -write a job description and list of duties, knowledge, skills and abilities
2. Rate the job duties
3. Create the interview questions –situational questions, job knowledge questions etc
4. Create benchmark answers with a five point rating scale
5. Appoint an interview panel and conduct interview – 3 – 6 members preferably the same employees who wrote the questions , also include job supervisor and/or incumbent, and an HR representative
6. Meet to allocate interview responsibilities and train if need be.



Interview question structure

- **Structure your interview questions so** that it is standardized, consistent and relevant. This will include ensuring that :
 - You base your questions on action job
 - Use knowledge, situational and behavior oriented questions and an objective criteria to assess the interviewees response
 - Train your interviewers
 - Use the same questions for all candidates
 - Use rating scales to rate answers
 - Use multiple interviewers for panel interviews to reduce bias
 - Control the interview – limit the interviews follow up questions



- **2. Prepare for the interview**
- The interview should take place in a private room with minimum interruptions
- Prior to the interview, review the candidates application and resume and not areas that are vague or that may indicate strengths or weaknesses
- Remember the duties of the job and the specific skills and traits that you are looking for – review the job specifications
- Start the interview with an accurate picture of the traits for the ideal candidate.



- **3. Establish rapport** – put the person at ease – greet the applicant, drop in some courtesy words and start interview with non related question, e.g.. About the whether
- Be aware of peoples background and make additional efforts to make such people relax

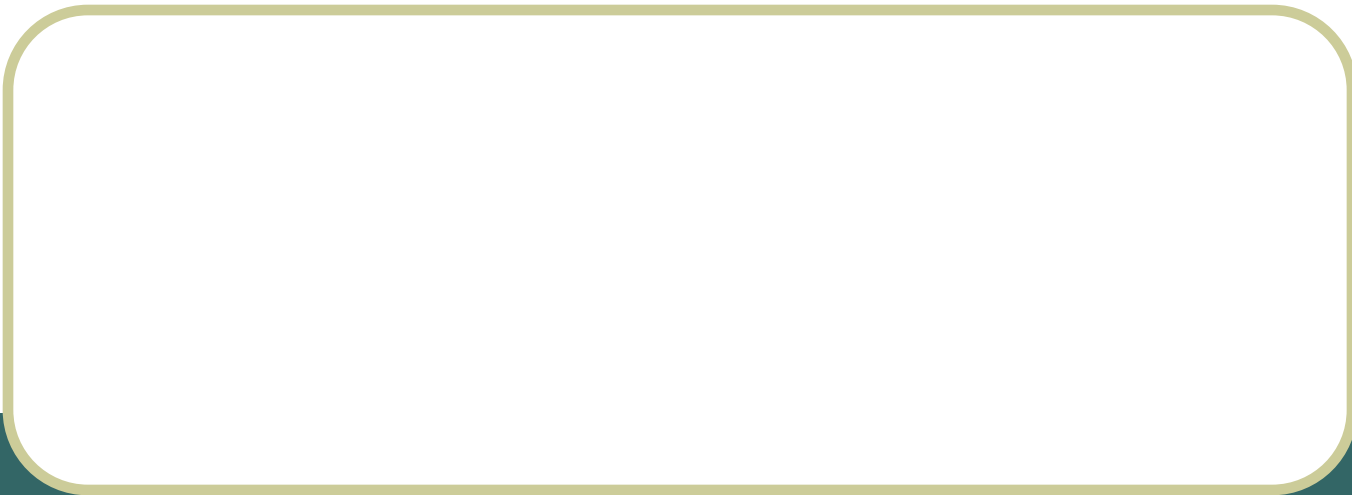


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- **4. Ask questions** – follow your list of questions.
- Don't ask questions which can be answered with yes or no, don't push words into the applicants mouth, don't interrogate the applicant as if the person is a criminal, don't be patronizing, sarcastic – ask open ended questions, listen to the candidate, , encourage them
- **5. Close the interview** – leave time to answer any questions the candidates may have
- End the interview with a positive note, tell the applicant the next steps, make any rejections diplomatically
- **6. Review the interview** – review notes and fill in the structured interview guide

***ORIENTATION, TRAINING
AND DEVELOPMENT***



Employee Orientation Programs

- purpose

- Reduce newcomer stress and anxiety - fear of failure on the job. It is a normal fear of the unknown, focused on the ability to do the job
- Reduce start-up costs
- Expedite proficiency/Skills/abilities
- Assist in newcomer assimilation
- Enhance adjustment to work group and norms

Purpose (cont...)

- To introduce new employees to the organization and to the employees new tasks, managers and work groups
- Help the new employee get started in the right direction and with a positive attitude and feeling
- Make the employee the person more comfortable, knowledgeable and ready to work within the firms culture, structure, and employees mix

Purpose (cont...)

- Send clear messages and provide accurate information about the company culture, jobs and expectations.
- Reduce turnover -If employees see themselves as ineffective, unwanted or unneeded, they may react to these feelings by quitting. Turnover is high during the break-in period and effective orientation can reduce this costly reaction

Purpose (cont...)

- To save time – improperly orientated employees must still get the job done, and to do so they need help. The most likely people to provide this help are co workers and supervisors, who will have to spend time breaking in new employees. Good orientation programs save everyone's time

Purpose (cont...)

- To develop realistic expectation - new employees must learn realistically what the organisation expects of them and their own expectations of the job must be neither too low nor too high.

Orientation Program Content

- Information about company as a whole
- Job-specific information

Company Information

- Overview of company
- Key policies and procedures
- Mission statement
- Company goals and strategy
- Compensation, benefits, safety
- Employee relations
- Company facilities

Job-Specific Information

- Department functions
- Job duties and responsibilities
- Policies, rules, and procedures
- Tour of department
- Introduction to departmental employees
- Introduction to work group

Who orients employees

- For smaller firms – operations managers do all the orientation
- Union officials will be involved where unions exist
- Ideally orientation starts with HRM who explain personal policies.
- Orientation should begin with the most relevant and immediate kind of information and then proceed to more general policies of the organisation – give the employee handbook which explains things like working hours performance review, payroll information, vacations etc

-
- The supervisor takes over from HR to explain the exact nature of the job, introduce the person to his/her colleagues, familiarizes the employee to the work place and help reduce first day jitter.
 - Then how long it should take to reach standards of effective work and encouraging them to seek help
 - Show the new worker the immediate environment

Induction of the employee

- Once orientation is complete, the employee is inducted into the new job but showing him details of how the job is done, identifying any gaps, and on job training to improve performance.
- The period of induction can be short or long depending on the expected scope of work for the employee. For some managers, they may require to spend some time in every department

TRAINING AND DEVELOPMENT

- Training and development are processes that attempt to provide an employee with information, skills, and understanding of the organisations of the organisation and its goals
- T & D is designed to help a person continue to make positive contribution in the form of good performance

Defining Training and Development

- *Training* is defined as:
 - Any attempt to improved employees performance on a currently held job or one related to it
 - This usually means changes in specific knowledge, skills, attitudes or behavior
 - It is the methods used you give new or present employees the skills they need to perform their job. It may mean job orientation, showing employees how to use new equipment or showing a sales persons how to sell

Training (cont..)

- It is a systematic process of altering the behavior of employees in a direction that will achieve organizational goals.
- Training is related to present job skills and abilities

Training (cont..)

- To effective, training should involve:
 - Learning experienced
 - Be a planned organizational activity
 - Be designed in response to identified needs
 - Should be designed to meet the goals of the organisation while simultaneously meeting the goals of the individual

Development

- Development refers to:
- Learning opportunities designed to help employees grow
- Such opportunities do not have to be limited to improving employees performance on their current job

Differences between training and devt

training	Development
Training usually refers to some kind of organized (and finite it time) event -- a seminar, workshop	Development is a process
Training has a beginning and end. Participants are exposed to knowledge and skills associated with new concepts during the event.	Employee development is a much bigger, inclusive "thing". For example, coaching and rotating of job responsibilities to learn about the jobs of their colleagues

Training	Development
Results of training is changes performance	Results of development is to changes lives
When we train people, we focus on the job	When we develop people, we focus on the person
When we train people, we're adding value to specific things, such as what their job description is.	When we develop people, we add value to everything. They not only become better in their jobs, they become better in life.

Training	Development
Employee training is a necessity for any business that wants to remain competitive in today's marketplace.	But leaders who want to make a lasting difference also recognize that training by itself is not enough and development will do
Training people is helpful for a short time,.	Developing people is helpful for a lifetime
Training often focuses on the immediate period to help fit any current deficit in employees skills.	The focus on development is on the long term to help employees prepare for future work demand

The five steps to training and development process

- Training programmes consist of five steps:
- 1. Needs analysis – identifying the specific job performance skills needed, analyzing the skills and needs of the prospective trainees, and developing specific measurable knowledge and performance objectives

-
- 2. Determine type of training
 - 3.. Instructional design – decide on, compile and produce training programme content, including workbooks, exercises, and activities
 - 4. Validation – pilot testing the programme
 - 4. implementation
 - 5. Evaluation and follow up

Training needs assessment

- Needs assessment results in data and information on:
- *What* type of training is needed
- *Who* should be trained
- *When* the training should be conducted
- And whether the training is the preferred *approach*

Analysing training needs

- The needs assessment is a process that is used to determine if and what type of training is necessary.
- It usually involves
 - *organizational analysis,*
 - *person analysis,*
 - *Task analysis*

Organizational analysis

- Involves examining the firms **mission, resources, and goals** to determine if training can be used to improve the firms success, growth and strategy
- It tries to answer the question on where the training emphasize should be placed in the company and what factors may affect training
- To do this an examination should be make of the organizational goals, personnel inventories, performance data and climate and efficiency indices
- The organisation financial, social, human resources, growth, and market objectives need to be matched with the human talent, structured, climate and efficiency

Organizational analysis (cont...)

- This examination should ideally be conducted in the context of the labour supply forecasts and gap analysis
- Organizational systems that may hamper training process should be explored
- Training does not exist in a vacuum and the context in which it occurs has an impact on whether individuals will learn

Organizational analysis (cont...)

- The review of short term and long term goals of an organisation and any trends that may affect the goals is done to channel the training toward specific issues of importance to the firm (e.g. international expansion, improved customer satisfaction, increased productivity etc)
- So if you are predicting layoff, you could retrain you employees for other roles which will be in demand

Organizational analysis (cont...)

- a human resources inventory can reveal projected employees mobility, retirement and turnover
- A review of climate and efficiency indexes is important to identify problems that could be alleviated with training
- Climate indexes are quality of work life indicators and include records of turnover, grievances, absenteeism, productivity, accidents, attitude survey, strikes etc

Organizational analysis (cont...)

- Job satisfaction indexes derive data on employees attitude towards work itself, supervision and coworker
- Efficiency indexes consists of cost of labour, material and distribution; quality of the products, downtime; waste; late deliveries; repairs
- These data are examined to find any discrepancy between desired and actual

Organizational analysis (cont...)

- It is also important to identify any organizational systems constraint on training. E.g.. if the benefits of training are not clear to top management, they may not plan and budget appropriately for training

Personal analysis

- Personal analysis involves the determination of who needs training, what type of training and the readiness for training
- Examining an employee's *performance* against a standard or compared with that of co-workers can help identify strengths, weaknesses and needs
- A process of verifying that there is a performance deficiency and determining if such deficiency should be corrected through training or through some other means (like improving the working environment)
- Determining whether training could reduce the employee's weaknesses

Personal analysis (cont..)

- There are several methods that can be used to determine the employees needs
 - Supervisor, peer, self and 360 performance reviews
 - Job related performance data (including productivity, absenteeism, accidents, sickness, grievances, waste downtime, customer complaints etc)
 - Observation by supervisor or other specialists
 - Interviews with the employee or his or her supervisor
 - Test of things like job knowledge, skills and attitude surveys
 - Individual employees daily diaries
 - Use of assessment centres

Personal analysis (cont..)

- The first step in performance analysis is comparing the persons performance with what it should be (actual vs. desired)
- E.g. how many new contacts a salesperson is expected to make per week and how many is John doing
- Distinguish between *can't do* and *won't do* problems

Personal analysis (cont..)

- If it's a case of *can't do* – find out the causes. E.g. The employee do not know what to do or what your standard are, there are obstacles in the system such as lack of telephone facilities, transport, tools or supplies; does not have the skills; inadequate training

-
- *Won't do* problem – here employees do a good job if they wanted to.
 - Perhaps you need to change the reward system
 - identifying the causes of the problem will help determine whether training will fix the problem

Task analysis

- *Task analysis* involves the identification of the task, knowledge, skills attitudes (K, S, A) that should be included in the training programme in order to improve on job performance
- Answers the question, what should be taught so that the trainee can perform the job satisfactorily
- Especially useful for determining the needs of employees new to the job
- When conducting a job analysis to determine training needs, both *worker oriented approach*, which focuses on Knowledge, Abilities, Skills and Other Related Characteristics (KASOCs), and a *task oriented* approach, which describes the work activities performed, should be used

Task analysis (cont..)

- The tool used for task analysis is mainly job description and job specifications because they list the specified duties and skills for a specific job and thus provide a basic reference point for the training required
- You could also uncover training needs by reviewing the performance standards, or you yourself performing the job, or questioning the current job holders and their supervisors

Task analysis (cont..)

- You could supplement the job description and specification with a task *analysis record form* which consolidates information regarding required tasks and skills in a form that's specially helpful in determining training requirements

Task analysis (cont..)

- Included in this form is
- List of tasks and for each task:
 - When and how often it is performed
 - Quantity and quality performance – e.g. 100% safety
 - Conditions under which performed – noisy pressroom
 - Skills or knowledge required
 - Where best learned – on the job, formal training etc

Training methods

- On job training
- Apprenticeship training
- Informal learning
- Job instruction training
- Lectures
- Programmed learning

On job training (OJT)

- Means having the person learn on the job by actually doing
- Commonly used for new employees, or when introducing new work methods
- Most common type of OJT is the *coaching* or *understudy methods*
- Here an experienced worker or the trainees superior trains the employee.
- It is used at lower levels, there a trainee may acquire skills by observing the supervisor.
- Also today it is being used at top management level too, where a potential future CEO might spend a year understudying the currently CEO
- *Job rotation*, common for management trainees is also another form of OJT
- Special assignments similarly give lower level executives firsthand experience in working on actual problems or specific locations

Requirements for a successful OJT

- Train the trainers themselves on OJT process
- Provide the necessary training material
- Train the trainers on the principles of learning

OJT steps

- PESOS formula
- Prepare
- Prepare yourself and the learner
- Prepare all equipment, materials etc
- Put the learner at ease
- Explain why he or she is being taught
- Create interest, encourage, find out what the learners knows,

Explain (present the operation)

- Explain the whole job and relate it to some job the worker knows already
- Familiarize the worker with equipment, materials, tools and terms
- Explain the quantity and quality requirements

Show

- Show the learner how the job is done
- Go through the job at a slow pace several times, explaining each steps and key points
- Have the learner explain the steps to you

Observe (do a tryout)

- Have the learner go through the job several times, slowly, explaining each step to you. Correct mistakes and if necessary do some of the complicated steps again
- Have the learner do the job at the normal pace

Supervise (follow up)

- Supervise the learners gradually decreasing supervision, checking from time to time against quality and quantity standards
- Correct faulty work patterns before they become a habit
- Complement good work; encourage until able to meet quality and quantity standards

Advantages of OJT

- It is relatively inexpensive
- Trainees learn while producing
- There is no need for expensive off site facilities like classroom
- Immediate feedback is given

Apprenticeship

- Apprentice training is a structured process by which people become skilled workers through a combination of classroom instruction and on the job training
- Widely used to train individuals for many occupations
- Involves have a learner/apprentice study under the tutelage of a master craftsman

Informal learning

- Informal learning is any learning that occurs in which the learning process is not determined or designed by the organisation
- Involves day today unplanned interactions between a new worker and his or her colleagues

Formal classroom training

- A quick and simple way to provide knowledge and skills to a large group of trainees,
- Uses several techniques:
 - Lectures
 - Case study methods
 - Role play
 - Group discussions
 - Management games (emphasizing development of problem solving skills)

Outdoor oriented programmes

- Are real life action oriented programmes
- Used for leadership, teambuilding and risk taking programmes
- Programmes conducted in remote areas, combining outdoor skills with classroom seminars .g. outward bound programs

Simulated training

- Is a method in which trainees learn on the actual or simulated equipment they will use on the job , but are actually trained off the job – necessary which its too cost or dangerous to train employees on the job

Computer based training

- The trainee uses computer-based and or CD-ROM systems to interactively increase his or her knowledge and skills
- Distant and internet based training
 - Includes traditional paper and pencil correspondence courses, teletraining, video conferencing and internet based classes

Which training approach to use?

- Deciding on an approach or a combination of approaches must be done by within various criteria:
 - The number of people to be trained
 - Availability of materials
 - Cost per person
 - Employees ability for training
 - The objective of training – what skills, knowledge, attitudes do you want to impart

Instructional design

- Once the needs have been identified the next step is to design the training programme
- This may involve:
- Creating the instructional content and programme yourself – by in-house staff or consultant
- Use already existing instructional content and packages

instructional package

- Developing an instructional package includes:
- 1. Developing learning objectives for the performance discrepancies identified (they should be SMART)
- 2. Develop content of the training which will enable you to achieve objectives
- Develop training materials to help you deliver your content effectively – handouts, case studies, experiment instructions etc
- Determine the training aids to be used

Management development

- Training for managers tend to be more future oriented , and more complex
- Definition – any attempt to improve managerial performance by imparting knowledge, changing attitudes, or increasing skills.
- The ultimate aim is of course to enhance future performance of the company itself

Process of management development

- Consists of:
 1. Assessing the company's strategic needs (for instance to fill future executive openings or to boost competitiveness)
 2. Appraising the managers' performance
 3. Developing the managers (and future managers)

Management development programmes

- Can be companywide and involve all or most of the new or potential managers
- Can be specific aimed at filling specific positions – usually this involves succession planning

Why management development

- Organizations and their environment are dynamic and constantly changing
- New technologies are developed
- Competitors enter and leave markets
- Inflation increases
- Productivity fluctuates
 - These are the kind of changes that managers face

Why management development (cont...)

- Hence the need to develop managers on a continuous basis
- Management development should be planned, and requires systematic diagnosis, development of programmes and the mobilization of resources (trainers, participants and teaching aids)

Target areas for management development

1. Individual
2. Group
3. Organizational

Individual management development

- One way is through goal setting
 - Goal setting is designed to improve individuals ability to set and achieve goals
- Another way is behaviour modification which is individual learning through reinforcement of desired behaviour.
- For this to be effective the manager must identifying the specific behaviour and this behaviour must be specifically observed and reliably recorded

Group based management development

- This is especially to improve the effectiveness of groups e.g. in:
- *Team building* – this is a development process which helps to prepare organisation member to work more effectively in groups

Organizational wide management development

- Here a total system is involved or that a clearly identified unit or department is the target
- E.g.
- TQM involves everyone in the firm

Evaluation of training and Development

- This is the final phase in training and development
- Evaluation is done by comparing the results (benefits) with the objectives of the training programme that were set at the assessment phase.

Criteria for evaluation

- The criteria used to evaluate training depends on the objective of the training
- There are three types of criteria for evaluating training
 - Internal
 - External
 - Participants reaction

Criteria for evaluation (cont...)

- Internal criteria are directly associated with the content of the programme – for example whether the employees learned the facts covered by the programme
- External criteria are related more to the ultimate purpose of the programme –for example improving the effectiveness of the training

Criteria for evaluation (cont...)

- Possible external criteria includes:
 - Performance rating
 - The degree of learning transferred from training and development sessions to on job situations
 - Increases in sales volume or decreases in turnover

Criteria for evaluation (cont...)

- Participants reaction or how the subject feels about the benefits of a specific training or development experience

Multiple criterion

- Some people say a multiple criterion should be used. This involves measuring the following:
- *Participants reaction* – whether the subjects liked or disliked the programme
- *Learning* – the extent to which the subject have assimilated the knowledge and skills offered (is assessed by giving tests)

Multiple criterion (cont..)

- *Behaviour* – an external measure of change or lack of change in job behaviour; the ratings a participant received in performance appraisal (comparison of “before” and “after” ratings)
- *Results* – the effect of the programme on organizational dimensions such as turnover, productivity, volume of sales, waste etc
- ROI – money value of the results (benefits of training minus training costs)

- By Azariah Soi

SEMS - UON

Contents

1. Access To Quality Seed

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ACCESS TO QUALITY SEED IS KEY TO SUCCESS IN AGRICULTURE.

An increase in the supply of quality seeds of improved varieties is critical to food security. This is particularly true to Africa where access to quality seeds by farmers is a major constraint to improvement in agricultural productivity.

Studies indicate that over 90% of the farmers in developing countries use farm saved seeds in their farms. Smallholder farmers represent a yet untapped opportunity to meet global food security challenges. By improving access to quality seeds of appropriate varieties, coupled with the right agronomic practices, the seed industry can play a major role in unlocking this potential.

Engagement of the private sector is high on the global sustainable development agenda. In its evaluation of the Millennium Development Goals, the United Nations highlighted the importance of improved crop varieties that have enabled farmers in the advanced agricultural systems to triple their yields. Based on that, it sees the seed industry as a crucial partner in addressing global food security challenges.

"The International Seed Federation (ISF) recognizes the important role played by seeds and genetic improvements in the fight against hunger and poverty. Seed companies the world over work hard to provide farmers with high-quality seed.

Seed is, however, only part of the solution to increasing agricultural output, and increasing output is only part of the solution to food security worldwide. ISF members and companies are working directly with farmers on a global level to find sustainable solutions to the problem of world hunger."

Michael Keller, Secretary General of the International Seed Federation

Table 1: **The Stages of Development of the Seed Sector and Their Main Characteristics**

Stage	Main Characteristics
Pre-industrial	<ul style="list-style-type: none"> € Subsistence agriculture, traditional varieties or landraces grown from farm- saved seed or seed obtained through exchange with other farmers. € Varietal improvement is in the hands of farmers. € No formal varietal registration or quality control standards. € No seed legislation, seed policies or intellectual property laws applying to seed.
Emergence	<ul style="list-style-type: none"> € Farming is still primarily subsistence, but surpluses may be sold on fledgling markets. € Some farmers adopt improved self- and open-pollinated varieties, fewer still experiment with hybrids. € Public sector organizations begin plant breeding and producing seed. Most seed is still farm- saved, but increasing numbers of farmers buy commercial seeds. € Public extension services play a key role in informing farmers of characteristics and benefits of new varieties and connecting farmers to sources of seed. € Legal framework for control of seed industry begins to take shape, often by adopting standards from more developed countries and international organizations. € Need for Intellectual Property Rights is still weak, as primary source of seed is still in the hands of the public sector.
Expansion	<ul style="list-style-type: none"> € Increasingly commercial crop production, with more of the crop sold rather than for home consumption. € Many farmers have adopted hybrid seeds of major crops, with very little farm-saved seed of these crops. € Open-pollinated varieties (OPVs) still dominate less commercial crops and 'orphan' crops, and farm-saved seed continues to dominate for these varieties. € Private sector becomes involved in plant breeding and seed production, and increasingly involved in providing technical information and 'extension'. € Quality control strengthens, but plant variety protection is still weak

Maturity	<ul style="list-style-type: none">• Agriculture is largely commercial, with hybrids dominating in high value crops.• Most farmers purchase seed annually.• Plant breeding increasingly in the private sector, although low-value, high-volume OPVs are still largely the domain of public sector breeding and small-to medium-scale seed enterprises.• Seed production is entirely in the private sector, and the private sector is increasingly the source of technical information for farmers.• Quality control standards are strongly enforced, and plant variety protection is in place and effectively implemented.
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SEMIS -

Table 2: **Adoption of Policy Support to the Respective Stages of the Development of the Seed Sector**

Stage	Best Practice
Pre-industrial	<ul style="list-style-type: none"> € Raise awareness of improved agricultural practices, and the importance of improved cultivars and the quality of seeds. € Support the production and supply of quality seed by promoting the best landraces or improved varieties available from elsewhere that is suited to local agroclimatic conditions. € Link farmer seed producers with sources of seed of improved varieties. € Make seed available through extension agents and key farmers, and support appropriate systems for marketing farmer-produced seed. € Develop farmers' participatory evaluation of cultivars and landraces, and invest in collecting and characterizing traditional landraces and potentially suitable modern cultivars, and in training in all aspects of seed production, health and storage. € Develop a national seed policy, seed plan and flexible seed legislation to provide the framework of institutional mechanisms for seed production, quality control and trade. € Develop policies based on own circumstances and interests, and avoid importing non-adapted policies from mature seed industries.

Emergence	<ul style="list-style-type: none"> ∄ Focus is on strengthening the foundations established during the pre-industrial phase. ∄ Promote demand for improved seed including multilocational variety testing and demonstration trials. ∄ Strengthen extension services to ensure that farmers are aware of new varieties and their characteristics. ∄ Establish public-sector seed production, certification and quality control Agencies and seed-testing laboratories to provide the foundations of the fledgling seed sector. ∄ Support low rate credit schemes to establish seed-processing and quality-control facilities, to facilitate the establishment of small-scale seed enterprises. ∄ Support agricultural universities and public-sector research centres for plant breeding, seed research and business management for seed enterprises. ∄ Train in seed production, quality control and seed certification. ∄ The policy environment should be supportive of the smallholder seed producers and the informal seed sector. ∄ Plant breeders' rights may need to be introduced as a foundation for private-sector involvement in the seed sector, but policy should provide for 'farmers' privilege'.
Expansion	<ul style="list-style-type: none"> ∄ Continue to build demand for seed, and to provide a policy environment that encourages private-sector involvement in seed production and marketing. ∄ Public sector may reduce its direct involvement in such activities as seed production, quality control and certification and seed supply systems, allowing these to be taken up by the private sector, albeit with continued public-sector oversight. ∄ Public sector will still be the primary locus for breeding and improvement of open- and self-pollinated crops. ∄ Support infrastructure development for seed production (processing and storage), distribution (transport network) and marketing. ∄ Policy should aim to ensure availability of low rate

	credit both to seed enterprises (and contract growers) and to farmers to purchase seed.
Maturity	<ul style="list-style-type: none"> € Provide a policy environment that encourages a balance of public and private investments in the seed sector. € IPRs will need to be provided to stimulate private-sector investment in plant breeding and extension activity. € Continued need for public-sector involvement in low-value open- or self-pollinated crops which do not offer adequate returns for private sector investment. € Seed certification and variety registration policies can be more strictly applied at this stage, with many associated activities privatized, albeit with standards set and monitored by government agencies. € Government should continue its investment in fundamental research and education, but training in technical skills in seed production and processing can increasingly be taken on by the private sector.

Source: FAO, KEPHIS

Key Factors for Successful Seed Enterprise Development

- € Conducive policy environment
- € Demand for quality seed
- € Access to improved varieties
- € Technical skills and capacity
- € Access to affordable credit
- € Infrastructure
- € Communication and marketing
- € Efficient distribution network
- € Sustainability (no dependency on external support)

CONCLUSION

Agriculture remains the mainstay of our economies in the developing countries thus, the demand for high quality seed for crops that are adaptable to various agro ecological zones (AEZs) across Africa is far beyond the supply. The small and medium seed enterprises need to play the crucial role of ensuring availability, easy access by farmers and consistent supply of high quality seed to meet the ever growing demand. There is also a need for the enterprises to lobby governments for a favourable policy environment to enable them to prosper in order to effectively produce and distribute quality seeds.

Azariah Soi General Manager

Simlaw Seed Co. Ltd www.simlaw.co.ke

- By Peter K. Mulwa

Contents

1. Ict Applications In Seed Business Management

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ICT APPLICATIONS IN SEED BUSINESS MANAGEMENT

DATA ANALYSIS USING MS EXCEL TOOLS

By: Peter K. Mulwa

MSc (UoN), PGDE (KU), BSc (KU)

Email: Peter.kyalo@uonbi.ac.ke

Objectives

By the end of the session, participants should be able to:

- a) Identify Ms Excel tools used for data analysis
- b) Analyze data using the tools

Ms Excel for Data Analysis

- Ms Excel provides powerful tools that for data analysis which include:
 - a) Sort:** Help to arrange data in either ascending or descending order. You can sort your data on one column or multiple columns
 - b) Filter:** This is a tool used to display records that meet a certain criteria
 - c) Conditional Formatting:** Conditional formatting enables one to highlight cells with a certain color, depending on the cell's value.

Ms Excel for Data Analysis

- d) **Charts:** Enables one to present data in graphical form
- e) **Pivot Tables:** A pivot table allows one to extract the significance from a large, detailed data set. It enables one to view data in summarized form which enable one to draws a meaning from the data
- f) **Tables:** Tables allow one to analyze data quickly and easily.

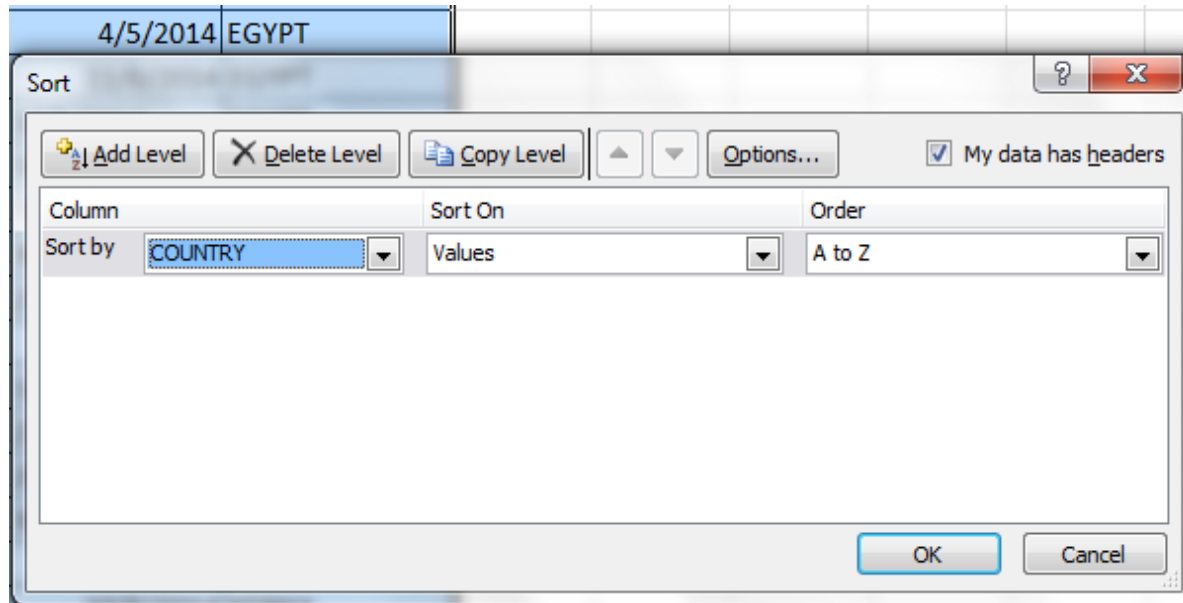
Ms Excel for Data Analysis

- g) What-If Analysis:** What-If Analysis in allows one to try out different values (scenarios) for formulas and predict the possible outcomes based on different scenarios
- h) Solver:** This tool uses techniques from the operations research to find optimal solutions for all kind of decision problems
- i) Analysis ToolPak:** The Analysis ToolPak is an Excel add-in program that provides data analysis tools for financial, statistical and engineering data analysis.

Sort

- Steps:
 - i. With an open worksheet, click inside the data that you want to sort
 - ii. Click on data tab
 - iii. Click on sort from the data ribbon
 - iv. The sort dialog box below appear;

Sort



- v. Select the field to sort by
- vi. Select the order to sort by
- vii. Click Ok

Filter

- One can do simple filter or advanced filter
 - Steps for simple filter:
 - i. Click inside the data you want to filter
 - ii. Click on the data table
 - iii. Click on filter under sort & filter group
 - iv. Click on the drop arrow next to the field you want to filter by
 - v. Select the field to filter by
 - vi. Click Ok
- NB:** Click on filter under sort & filter group again to clear the filter arrows

Filter

	D	E	F	G
	AMOUNT	DATE	COUNTRY	
	\$ 7			
	\$ 4,8			
	\$ 6,5			
	\$ 7,5			
	\$ 6,5			
	\$ 2,0			
	\$ 4,6			
	\$ 4,5			
	\$ 8			
	\$ 2,5			
	\$ 2,5			
	\$ 6,5			
	\$ 6,5			
	\$ 4,5			
	\$ 4,5			
	\$ 5,8			
	\$ 9,0			
	\$ 5,000.00	27/6/2014	KENYA	
	\$ 7,540.00	23/6/2014	KENYA	
	\$ 5,260.00	29/6/2014	KENYA	
	\$ 3,000.00	25/6/2014	LIBERIA	

Sort A to Z
 Sort Z to A
 Sort by Color
 Clear Filter From "COUNTRY"
 Filter by Color
 Text Filters

Search

- (Select All)
- EGYPT
- GHANA
- KENYA
- LIBERIA
- NIGERIA
- SOUTH AFRICA
- TANZANIA
- TUNISIA
- UGANDA

OK Cancel

Filter

Steps for Advanced filter:

- i. Set the criteria range in two cells on adjacent rows using a field name and the condition
- ii. Click inside the worksheet
- iii. Click on data tab
- iv. Click on advanced filter under sort & filter group to display the dialog box below;



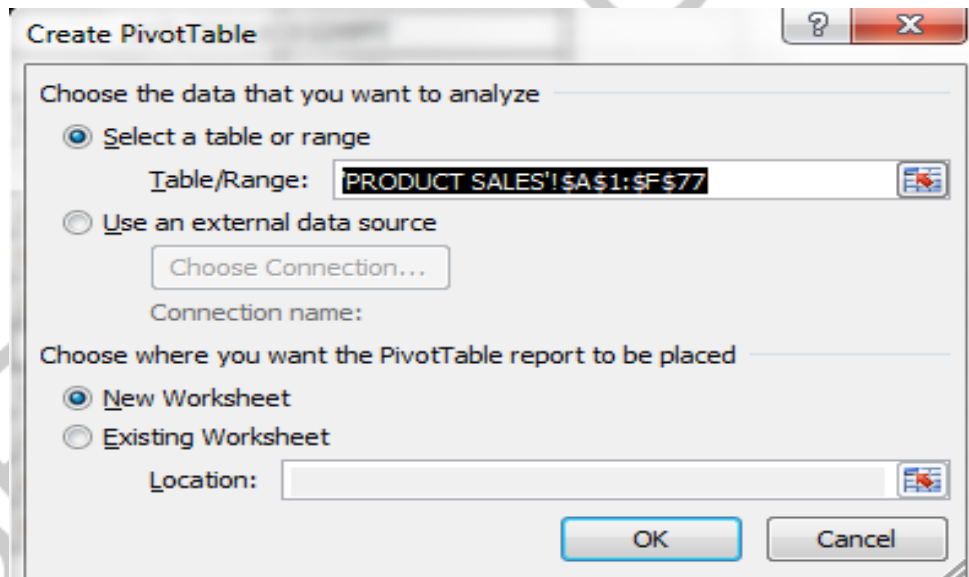
Filter

- v. Select the list range and the criteria range
- vi. You can copy the filtered data in another location within the same sheet or a different sheet by choosing the copy to another location option on the dialog box
- vii. Click Ok

PivotTables

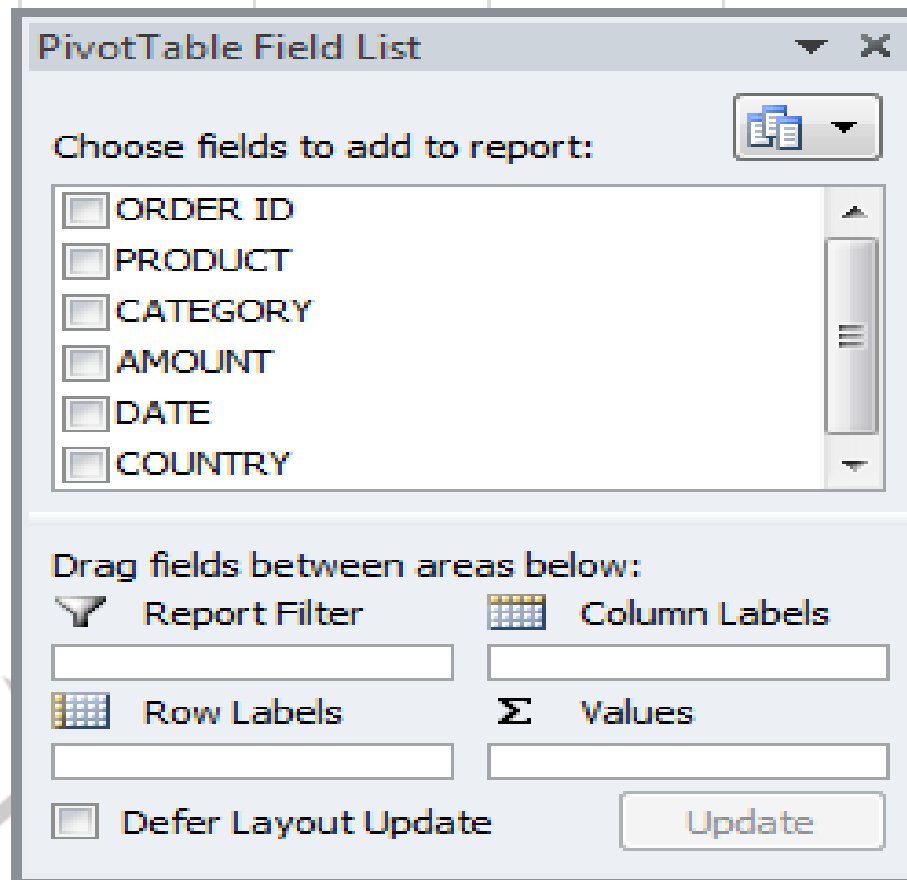
Steps:

- i. Click on insert tab
- ii. Click on pivot tables from the ribbon
- iii. The create PivotTable dialog box below appears;
- iv. Click Ok



PivotTables

- The PivotTable field list appears;



PivotTables

- In our sample data, to get the total amount exported for each product, drag the following fields to the different areas;
 1. Product Field to the Row Labels area
 2. Amount Field to the Values area
 3. Country Field to the Report Filter area
- A PivotTable as the one below appears and changes as you select different fields

PivotTables

The screenshot shows Microsoft Excel with a PivotTable summarizing product sales data. The PivotTable is located in the range A4:B16. The PivotTable Field List task pane is open on the right side of the window, showing the configuration for the PivotTable.

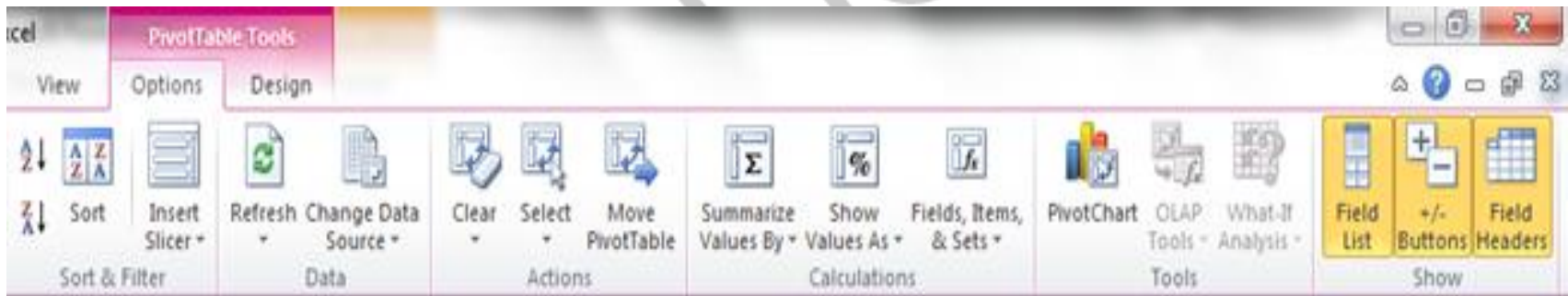
Row Labels	Sum of AMOUNT
APPLE	79784
BANANA	37915
BEANS	18600
BROCCOLI	25249
CABBAGE	29870
CARROTS	35470
LEMON	10812
MANGOS	26830
ONIONS	30150
ORANGE	26310
SUKUMAWIKI	49794
Grand Total	370784

PivotTable Field List Configuration:

- Choose fields to add to report:
 - ORDER ID
 - PRODUCT
 - CATEGORY
 - AMOUNT
 - DATE
 - COUNTRY
- Drag fields between areas below:
 - Report Filter: CATEGORY, COUNTRY
 - Column Labels: (empty)
 - Row Labels: PRODUCT
 - Values: Sum of AMOUNT
- Defer Layout Update
- Update

PivotTables

- You can sort, filter and change the summary calculations using the options provided under the PivotTable tools shown below;



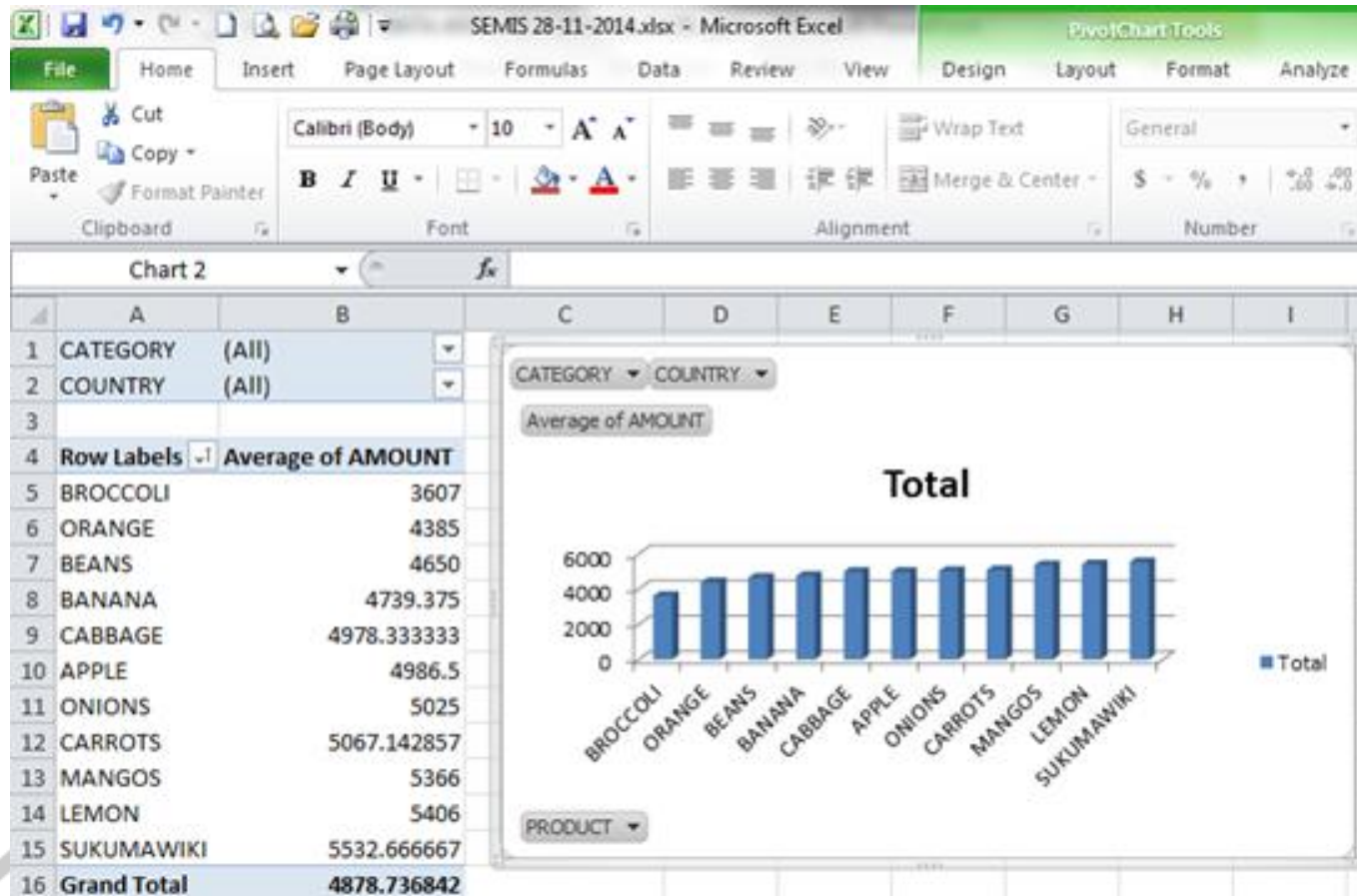
PivotChart

- Steps for inserting PivotChart
 - i. Click on the PivotTable
 - ii. Click on PivotTable tools
 - iii. Under options, click on PivotChart
 - iv. From the insert chart dialog box, select the type of the chart to use e.g. 3-D Clustered Column
 - v. Click Ok

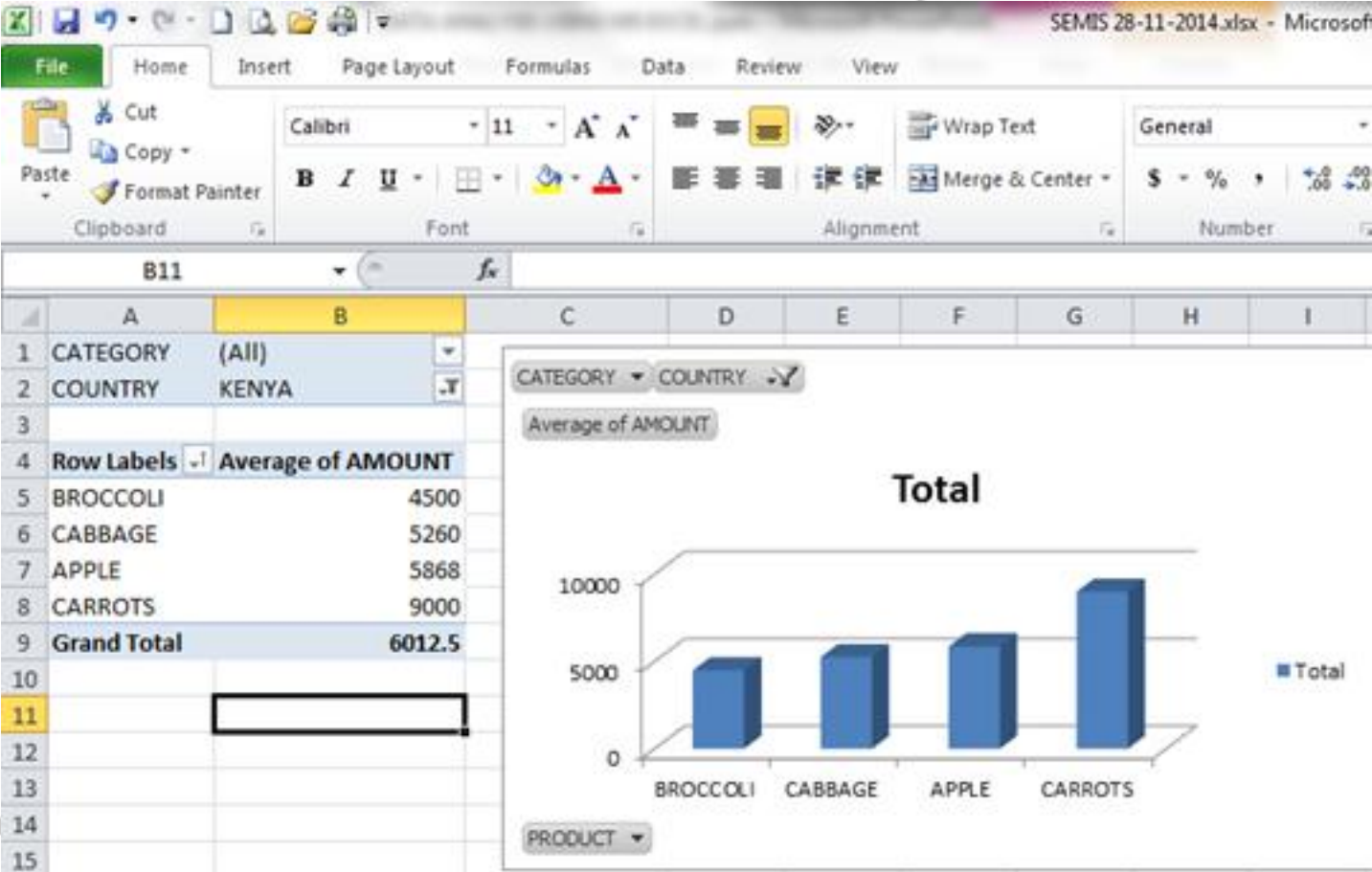
NB 1: Under PivotChart tools, you can change chart layout options as you want e.g. chart title, chart axis titles, etc

NB 2: The chart display changes as you change the filter criteria under the PivotTable e.g.

PivotChart with all data in the PivotTable



PivotChart with filtered data in the PivotTable



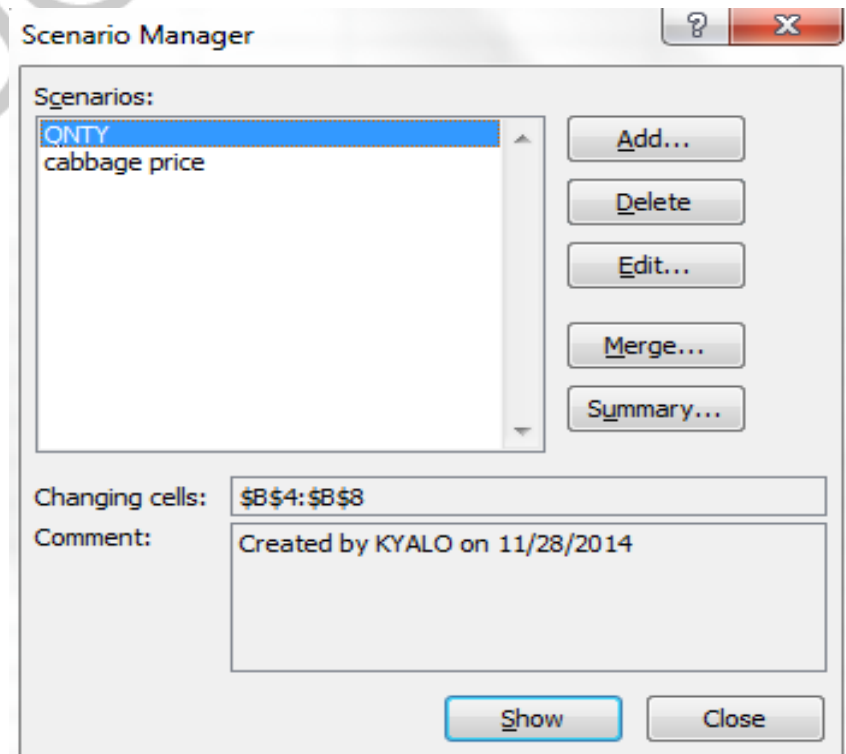
WHAT-IF ANALYSIS

- What-If Analysis allows one to try out different values (scenarios) for formulas and predict the possible outcomes based on different scenarios
- Steps
 - i. Click on your worksheet
 - ii. Click on data tab
 - iii. Click on What-if Analysis on the data ribbon
 - iv. Choose to use scenario manager or goal seek or table

WHAT-IF ANALYSIS

Using the Scenario Manager

- Click on Scenario Manager from What-if-Analysis drop down list
- The dialog box below appears;



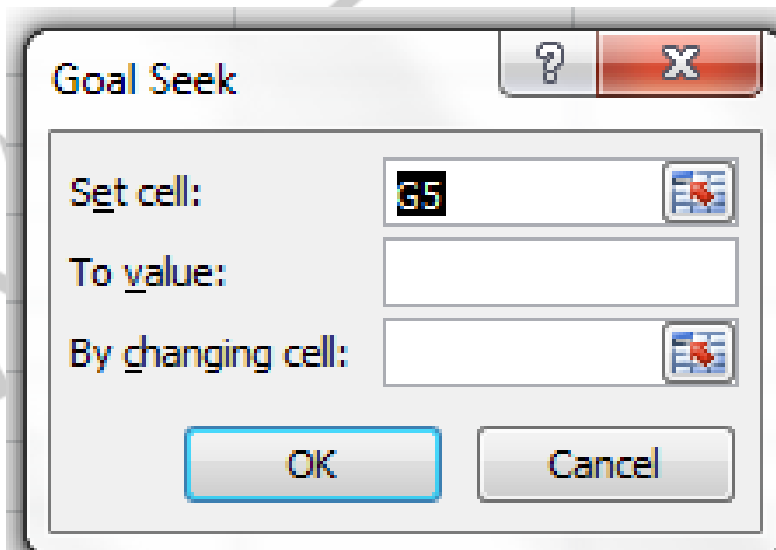
WHAT-IF ANALYSIS

- v. Click on add to add a Scenario
- vi. Type scenario name
- vii. Choose the changing cells e.g. Quantity
- viii. Enter new values for the changing cells
- ix. Click ok
- x. Then click show to view the changes in the calculated values

WHAT-IF ANALYSIS

- Using the Goal Seek
 - i. Select the cell containing the formula that will return the result you're seeking; in this example, cell G5
 - ii. On the Data tab, choose What-If Analysis→Goal Seek in the Data Tools group

NB: Dialog box below appears;



WHAT-IF ANALYSIS

- iii. **Select the To Value text box and enter the goal**
- iv. **Select the By Changing Cell text box and select the cell that you want to change**
- v. **Click OK**
- vi. **If you want to keep the values entered in the worksheet as a result of goal seeking, click OK as in the diagram below;**

WHAT-IF ANALYSIS

	A	B	C	D	E	F	G
1	WHAT IF ANALYSIS						
2							
3	PRODUCT	QUANTITY (KGS)	UNIT BUYING	TOTAL BUYING PRICE	UNIT SELLING PRICE	SELLING PRICE	PROFIT
4	BEANS	500.00	105.00	52,500.00	120.00	60,000.00	7,500.00
5	MAIZE	350.00	126.00	44,100.00	144.00	50,400.00	6,300.00
6	SOGHURM	250.00	89.00	22,250.00	101.71	25,428.57	3,178.57
7	MILLET	420.00	95.00	39,900.00	108.57	45,600.00	5,700.00
8	PEAS	600.00	98.00	58,800.00	112.00	67,200.00	8,400.00
9	TOTAL SALES			217,550.00		248,628.57	31,078.57
10							
11							
12		PROFIT MARGING			14%		
13							
14							
15							
16							
17							
18							
19							
20							
21							

Goal Seek Status

Goal Seeking with Cell G4 found a solution.

Target value: 7500
Current value: 7,500.00

Step
Pause
OK
Cancel

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...END...

- By Dan Chirchir



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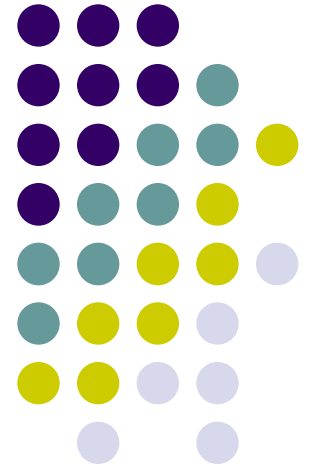
1. Cost and Budgeting
2. Finance Functions
3. Financial Planning & Working Capital Management
4. Investment Decisions
5. Seed FS



SEMIS 2015

Cost Management and Budgeting

Dan Chirchir



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COST MANAGEMENT

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Overview

- Cost management is one of the most important roles that management of any firm or organization has to play.
- In these times of economic downturn, cost management has gained prominence and attention of managers the world over.
- A deep grasp of the concept of cost is key since it is one of the elements that have huge impact in other facets of the organization.



Overview

- For instance, pricing of products will be informed by the cost of production.
- Ultimately, the bottom line of the any company may be affected significantly by cost of production and delivery of services.
- In the ensuing paragraphs, we discuss the basic concepts of costing and how to manage costs.



Definitions

Cost

The term cost is a frequently used word that reflects monetary measure of the resources sacrificed or foregone to achieve a specific objective, such as acquiring a good or service. (by Drury)

Cost object

It is any activity for which a separate measurement of costs is desired. Examples of costs objects include the cost of a product, the cost of rendering a service to a bank customer or hospital patient, the cost of operating a particular sales territory

Cost collection system

It is a system that typically accounts for costs in two broad stages:
It accumulates costs by classifying them into certain categories such as labour, materials, and overhead costs (or by cost behaviour such as fixed and variable)
It then assigns these costs to cost objects.



Definitions

Cost

The term cost is a frequently used word that reflects monetary measure of the resources sacrificed or foregone to achieve a specific objective, such as acquiring a good or service. (by Drury)

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It then assigns these costs to cost objects.



Classification of costs

A) Categories of manufacturing costs

Traditional cost accounting systems accumulate product cost as follows:

Direct material costs- consist of all those materials that can be identified with a specific product.

Direct labour costs- consist of those labour costs that can be specifically traced to or identified with particular product.

Manufacturing overhead- consist of all manufacturing costs other than direct labour, direct materials and direct expenses.



Classification of costs

B) Period and product costs

- **Product costs** – These are costs that are identified with goods purchased for resale.
- **Period costs**-These are costs that are not included in the inventory valuation and as a result are treated as expenses in the period in which they are incurred.



Classification of costs

C) Cost Behaviour

Analyses costs on how it varies with different levels of activity and volume. This is essential for decision-making. Activity or volume can be measured in terms of units of production or sales, hours worked, miles traveled, students enrolled etc

Examples of decisions that require information on how costs and revenue vary with different levels of activity include the following:

What should the level of activity be for next year?

Should we reduce the selling price to sell more units?

Would it be wiser to pay our sales staff by a straight commission, a straight salary, or by some combination of the two?

How do the costs and revenues of a hotel change with if a room and meals are provided for two guests for seven-day stay?



Classification of costs

C) Cost Behaviour

For each of the above decision management requires estimate of costs and revenues at different levels of activity for the alternative courses of action.

Variable costs - vary in direct proportion of to the volume of activity.

Fixed costs - remain constant over wide range of activities.

Semi variable cost-these include both a fixed and a variable component. Example is where sales representatives are paid a fixed salary plus commission on sales.



Classification of costs

D) Relevant and Irrelevant Costs and Revenues

Relevant costs - are those future costs that will be changed by a decision

Irrelevant costs - are those costs that will not be affected by a decision.

Sunk costs - are costs that have been created by a decision made in the past and that cannot be affected by any decision that will be made in the future.



Classification of costs

E) Opportunity Costs

This is a cost that measures the opportunity that is lost or sacrificed when the choice of one course of action requires that an alternative course of action be given up.



Classification of costs

F) Incremental and marginal Costs

Incremental cost-are the difference between costs and revenues for the corresponding items under each alternative being considered.

Marginal costs (an economics concept) - are the additional costs of producing one extra unit of product.



Managing costs: Overview

The first step in managing costs is to understand how cost is accumulated in the organization.

As explained earlier, proper cost analysis is prerequisite for proper pricing of products and services.

The traditional cost accumulation system allocates costs based on some pre-determined over-head absorption rates.

This system does not provide information such as what are the cost drivers of a particular product or service.



Managing costs: Overview

This limitation led to the advancement of other techniques of cost accumulation that would be useful to the decision maker.

The introduction of responsibility accounting and Activity Based Costing (ABC) system has revolutionalised cost management in many organisations.

Managing costs: Responsibility Accounting



- It involves the creation of responsibility centre. A responsibility may be defined as an organization unit for whose performance a manager is held accountable.
- A responsibility accounting system uses the concept of controllable costs to assign managers the responsibility for costs and expenses under their control.

Managing costs: Responsibility Accounting



Prior to each reporting period, a company prepares plans that identify costs and expenses under each manager's control.

These plans are called responsibility accounting budgets.

To ensure the cooperation of managers and the reasonableness of budgets, managers should be involved in preparing their budgets



ABC COSTING

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ABC Costing overview

Activity-based costing (ABC)

It attempts to better allocate costs to the proper users of overhead by focusing on activities.

Costs are traced to individual activities and then allocated to cost objects.

An example is (two-stage) activity-based cost allocation method.

First stage identifies the activities involved in processing jobs 236, 237, and 238 and then forms activity cost pools by combining these activities into sets.

The second stage involves computing predetermined overhead cost allocation rates for each cost pool and then assigning costs to jobs.



ABC Costing overview Cont'

Activity-based costing (ABC) Cont;

The first stage identifies individual activities, which are then pooled in a logical manner into homogenous groups, or cost pools.

A homogenous cost pool consists of activities that belong to the same process and/or are caused by the same cost **driver**.

A cost driver is a factor that causes the cost of an activity to go up or down. For example, preparing an invoice, checking it, and dispatching it are activities of the "invoicing" process and can therefore be grouped in a single cost pool.

Moreover, the number of invoices processed likely drives the costs of these activities.



ABC Costing overview cont'

Activity-based costing (ABC) Cont;

An **activity** cost **pool** is a temporary account accumulating the costs a company incurs to support an identified set of activities. Costs accumulated in an activity cost pool include the variable and fixed costs of the activities included in the pool.

Variable costs pertain to resources acquired as needed (such as materials), whereas fixed costs pertain to resources acquired in advance (such as equipment).

An activity cost pool account is handled like a factory overhead account. In the second stage, after all activity costs have been accumulated in an activity cost pool account, costs are allocated to cost objects (users) based on cost drivers (allocation bases).



Illustration

ABC limited makes 4 product namely (A, B, C and D) and the following information is provided:

	Products			
	A	B	C	D
Output (units)	25	25	250	250
No. of production runs	3	4	7	10
Labour hours per unit	2	4	2	4
Machine hours per unit	2	4	2	4
Material cost per unit	30	75	30	75
Material component per unit	8	5	8	6



Illustration cont'

Direct labour cost is Sh. 7 per hour

The company's overheads is as follows:

Overheads	Sh.
Short-term variable	8,250
Scheduling costs	7,680
Set-up costs	3,600
Material handling	7,650
Total	27,180

Determine the cost per unit using (a) the conventional costing (use machine hours) and (b) Activity Based costing



Suggested Solution

A) Conventional absorption costing

Overhead absorption rate	= Total Overhead/Base rate
Total Base machine hours	1,650
Total overheads	27,180
OAR	16.47



Suggested Solution cont'

A) Conventional absorption costing

Cost summary	Products			
	A	B	C	D
Direct Material	30	75	30	75
Direct Labour	14	28	14	28
Absorbed Overhead	33	66	33	66
Total Cost per unit	77	169	77	169



Suggested Solutions cont'

B) ABC method

Overhead absorption rates workings

Short-term variable OH	OAR	=	<u>8,250</u>	
			<u>1,650</u>	Total machine hours
		=	5	Per machine hour
Scheduling cost	OAR	=	<u>7,680</u>	
			24	Total production runs
		=	320	Per production run
Set-up cost	OAR	=	<u>3,600</u>	
			24	Total production runs
		=	150	Per production run
Material handling	OAR	=	<u>7,650</u>	
			<u>3,825</u>	Total material component
		=	2	Per material component



Suggested Solution cont'

B) ABC method

Cost summary	Products			
	A	B	C	D
Direct Material	30	75	30	75
Direct Labour	14	28	14	28
Short-term variable overhead	10	20	10	20
Scheduling costs	38	51	9	13
Set-up costs	18	24	4	6
Material handling	16	10	16	12
Total Cost per unit	126	208	83	154



Suggested Solution cont'

B) ABC method

Conclusion

The cost of A and B is significantly understated in conventional method because they are low volume measures but high transaction measure.



EFFECTIVE COST CONTROL SYSTEM



Overview

- Producing information in management accounting form is expensive in terms of the time and effort involved.
- It will be very wasteful if the information once produced is not put into effective use.

SEMIS



Parts of effective cost control system

There are five parts to an effective cost control system. These are:

- a) preparation of budgets
- b) communicating and agreeing budgets with all concerned
- c) having an accounting system that will record all actual costs
- d) preparing statements that will compare actual costs with budgets, showing any variances and disclosing the reasons for them, and
- e) taking any appropriate action based on the analysis of the variances in d) above.



Parts of effective cost control system

- Action(s) that can be taken when a significant variance has been revealed will depend on the nature of the variance itself. Some variances can be identified to a specific department and it is within that department's control to take corrective action. Other variances might prove to be much more difficult, and sometimes impossible, to control.
- Variances revealed are historic. They show what happened last month or last quarter and no amount of analysis and discussion can alter that. However, they can be used to influence managerial action in future periods.



Cost reduction strategies

Management should focus their cost reduction strategies in the following key areas:

- Focus on performance improvement not cost reduction

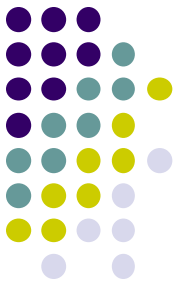
- Focus on enabling effective management of support services

- Build performance management tools to focus on the true drivers of business performance and maintain focus on achieving and maintaining performance targets



BUDGETS

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Overview

- There are two types of control,
 - ✓ namely budgetary and
 - ✓ financial.
- This section concentrates on budgetary control.



Overview

- Budgetary control is defined by the Institute of Cost and Management Accountants (CIMA) as:
- "The establishment of budgets relating the responsibilities of executives to the requirements of a policy, and the continuous comparison of actual with budgeted results, either to secure by individual action the objective of that policy, or to provide a basis for its revision".



Definitions

- Omolehinwa (1989) defined a budget as a plan of dominant individuals in an organization expressed in monetary terms and subject to the constraints imposed by the participants and the environments, indicating how the available resources may be utilized, to achieve whatever the dominant individuals agreed to be the organisation's priorities.
- The impressive thing about this definition is that, it recognizes the constraint imposed on budget by other participants who are to ensure that the objectives and targets enunciated in the budget are achieved.



Definitions

- Pandey (2003) defines budget as a short term financial plan. It is an action plan to guide managers in achieving the objectives of the firm.
- Lucey (2003) in his recent definition of budget defines it as “a quantitative expression of a plan of action prepared for the business as a whole for departments, for functions such as sales and production or for financial resource items such as cash, capital expenditure, manpower purchase, etc. The process of preparing and agreeing budgets is a means of translating the overall objectives of the organization into detailed, feasible plans of action”

Budget Organisation and Administration



In organising and administering a budget system the following characteristics may apply:

a) *Budget centres:* Units responsible for the preparation of budgets. A budget centre may encompass several cost centres.

b) *Budget committee:* This may consist of senior members of the organisation, e.g. departmental heads and executives (with the managing director as chairman). Every part of the organisation should be represented on the committee, so there should be a representative from sales, production, marketing and so on.

Budget Organisation and Administration



Functions of the budget committee include:

Coordination of the preparation of budgets, including the issue of a manual

Issuing of timetables for preparation of budgets

Provision of information to assist budget preparations

Comparison of actual results with budget and investigation of variances.

Budget Organisation and Administration



c) *Budget Officer:* Controls the budget administration The job involves:

- liaising between the budget committee and managers responsible for budget preparation

- dealing with budgetary control problems

- ensuring that deadlines are met

- educating people about budgetary control.

Budget Organisation and Administration



d) *Budget manual:*

This document:

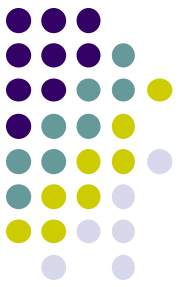
charts the organization

details the budget procedures

contains account codes for items of expenditure and revenue

timetables the process

clearly defines the responsibility of persons involved in the budgeting system.



Characteristics of a budget

A good budget is characterised by the following:

Participation: involve as many people as possible in drawing up a budget.

Comprehensiveness: embrace the whole organisation.

Standards: base it on established standards of performance.

Flexibility: allow for changing circumstances.

Feedback: constantly monitor performance.

Analysis of costs and revenues: this can be done on the basis of product lines, departments or cost centres.

Types of budgets and budget preparation



a) Sales budget: this involves a realistic sales forecast. This is prepared in units of each product and also in sales value. Methods of sales forecasting include:

sales force opinions

market research

statistical methods (correlation analysis and examination of trends)

mathematical models.

Types of budgets and budget preparation



In using these techniques consider:

company's pricing policy

general economic and political conditions

changes in the population

competition

consumers' income and tastes

advertising and other sales promotion techniques

after sales service

credit terms offered.



Types of budgets and budget preparation

b) Production budget: expressed in quantitative terms only and is geared to the sales budget. The production manager's duties include:

- analysis of plant utilization
- work-in-progress budgets.

If requirements exceed capacity he may:

- subcontract
- plan for overtime
- introduce shift work
- hire or buy additional machinery

The materials purchases budget's both quantitative and financial.

Types of budgets and budget preparation



c) Raw materials and purchasing budget:

The materials usage budget is in quantities.

The materials purchases budget is both quantitative and financial.

Factors influencing the above include:

production requirements

planning stock levels

storage space

trends of material prices.

Types of budgets and budget preparation



d) Labour budget: is both quantitative and financial. This is influenced by:

- production requirements

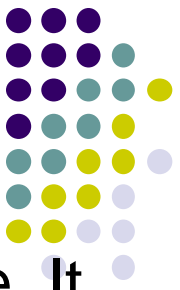
- man-hours available

- grades of labour required

- wage rates (union agreements)

- the need for incentives.

Types of budgets and budget preparation



e) Cash budget: a cash plan for a defined period of time. It summarises monthly receipts and payments. Hence, it highlights monthly surpluses and deficits of actual cash. Its main uses are:

- to maintain control over a firm's cash requirements, e.g. stock and debtors

- to enable a firm to take precautionary measures and arrange in advance for investment and loan facilities whenever cash surpluses or deficits arises

- to show the feasibility of management's plans in cash terms

- to illustrate the financial impact of changes in management policy, e.g. change of credit terms offered to customers.

Types of budgets and budget preparation



Receipts of cash may come from one of the following:

cash sales

payments by debtors

the sale of fixed assets

the issue of new shares

the receipt of interest and dividends from investments.

Types of budgets and budget preparation



Payments of cash may be for one or more of the following:

- purchase of stocks

- payments of wages or other expenses

- purchase of capital items

- payment of interest, dividends or taxation.

Types of budgets and budget preparation



- **Flexible Budgets** – budgets that take account of changing business conditions
- **Operating Budgets** – based on the daily operations of a business
- **Objectives Based Budgets** - Budgets driven by objectives set by the firm
- **Capital Budgets** – Plans of the relationship between capital spending and liquidity (cash) in the business



Illustration

- Company XYZ has the following data from which the master budget has to be prepared.

	Year 0	Year 1				Year 2
	Quarter 4	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Quarter 1
Sales (units)	1,800	1,000	2,000	1,500	2,000	1,000

Inputs	Requirement	unit cost
Direct material	2 kg per unit	Sh 5 per 1 kg
Direct labour	3 hrs per unit	Sh 10 per 1 hour



Illustration

- Beginning inventory of finished goods for each quarter must be equal to 10% of the sales of the previous quarter.
- Raw materials at the end of each quarter must be equal to the requirements to produce the units for sale in the next quarter
- Expected selling price is sh 200 per unit
- Variable manufacturing overhead are based on direct labour cost at the rate of 80% of direct labour cost
- Fixed manufacturing overhead per quarter is sh 20,000
- Selling and administration expense is Sh 96,000 per quarter



Illustration Cont'

- Sales are made on cash and credit terms in the ratio of 30:70 respectively
- Credit sales are collectable in the quarter following the quarter of sale
- Raw materials are paid in the month of purchase
- Wages, overheads and administration expenses are paid in the month they are incurred
- Equipment worth Sh. 380,000 will be bought in the 4th quarter of year 1.
- The beginning cash balance is Sh 27,000



Illustration cont'

Required

Prepare

Sales budget

Production budget

Raw material purchase budget

Direct labour cost budget

Manufacturing overhead budget

Income statement

Cash budget



Suggested Solution

a) Sales Budget

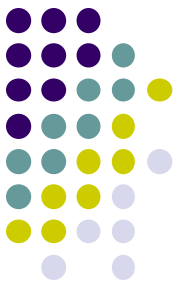
Sales budget	Units	Selling price	Amount
Quarter 1	1,000	200	200,000
Quarter 2	2,000	200	400,000
Quarter 3	1,500	200	300,000
Quarter 4	2,000	200	400,000
Total			1,300,000



Suggested Solution

b) Production Budget

	Budgeted	Closing	Beginning	Units to
Quarters	sales	inventory	inventory	produce
1	1,000	100	(180)	920
2	2,000	200	(100)	2,100
3	1,500	150	(200)	1,450
4	2,000	200	(150)	2,050



Suggested Solution

c) Raw Material Budget

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Units to produce	920	2,100	1,450	2,050
Requirement per unit	2	2	2	2
	1,840	4,200	2,900	4,100
Closing inventory	4,000	3,000	4,000	2,000
Less opening inventory	(2,000)	(4,000)	(3,000)	(4,000)
	3,840	3,200	3,900	2,100
Unit purchase price	5	5	5	5
	19,200	16,000	19,500	10,500



Suggested Solution

d) Direct labour cost budget

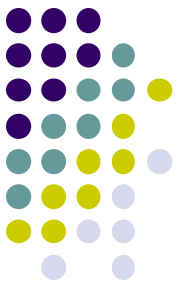
	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Units to produce	920	2,100	1,450	2,050
Direct labour hour per unit	3	3	3	3
Total labour hours required	2,760	6,300	4,350	6,150
Labour cost per hour	10	10	10	10
Total labour cost	27,600	63,000	43,500	61,500



Suggested Solution

e) Manufacturing overhead budget

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Labour cost	27,600	63,000	43,500	61,500
Variable Manufacturing OH (80% of labour cost)	22,080	50,400	34,800	49,200
Fixed Manufacturing OH	20,000	20,000	20,000	20,000
	42,080	70,400	54,800	69,200



Suggested Solution

f) Income Statement

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Units produced	920	2,100	1,450	2,050
Variable Manufacturing OH	22,080	50,400	34,800	49,200
Direct labour costs	27,600	63,000	43,500	61,500
Direct materials	9,200	21,000	14,500	20,500
Total variable costs	58,880	134,400	92,800	131,200
Cost per unit	64	64	64	64



Suggested Solution

f) Income Statement

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Sales	200,000	400,000	300,000	400,000
Less variable costs	64,000	128,000	96,000	128,000
Contribution margin	136,000	272,000	204,000	272,000
Less				
'fixed manufacturing OH	(20,000)	(20,000)	(20,000)	(20,000)
Selling & admin exp	(96,000)	(96,000)	(96,000)	(96,000)
Projected income	20,000	156,000	88,000	156,000



Suggested Solution

g) Cash budget

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Cash sales	60,000	120,000	90,000	120,000
Credit sale collection	252,000	140,000	280,000	210,000
Cash from sales	312,000	260,000	370,000	330,000
Beginning cash balance	27,000	154,120	168,720	324,920
Total cash available	339,000	414,120	538,720	654,920
Disbursement				
Raw materials	19,200	16,000	19,500	10,500
Wages	27,600	63,000	43,500	61,500
Overheads	42,080	70,400	54,800	69,200
Selling & Admin	96,000	96,000	96,000	96,000
Equipment	-	-	-	380,000
Total disbursement	184,880	245,400	213,800	237,200
Closing balance	154,120	168,720	324,920	417,720



Zero Base Budgeting

- After a budgeting system has been in operation for some time, there is a tendency for next year's budget to be justified by reference to the actual levels being achieved at present.
- One way of breaking out of this cyclical budgeting problem is to go back to basics and develop the budget from an assumption of no existing resources (that is, a zero base).
- This means all resources will have to be justified and the chosen way of achieving any specified objectives will have to be compared with the alternatives.



Zero Base Budgeting

- For example, in the sales area, the current existing field sales force will be ignored, and the optimum way of achieving the sales objectives in that particular market for the particular goods or services should be developed.
- This might not include any field sales force, or a different-sized team, and the company then has to plan how to implement this new strategy.



Zero Base Budgeting

- The obvious problem of this zero-base budgeting process is the massive amount of managerial time needed to carry out the exercise.
- Hence, some companies carry out the full process every five years, but in that year the business can almost grind to a halt.
- Thus, an alternative way is to look in depth at one area of the business each year on a rolling basis, so that each sector does a zero base budget every five years or so.



VARIANCE ANALYSIS

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Price and Quantity Variance

- Just to state that there is a variance on a particular item of expenditure does not really mean a lot.
- Most costs are composed of two elements - the quantity used and the price per unit.
- A variance between the actual cost of an item and its budgeted cost may be due to one or both of these factors.
- Apparent similarity between budgeted and actual costs may hide significant compensating variances between price and usage.



Price and Quantity Variance

- For example, say it is budgeted to take 300 man days at \$3.00 per man day - giving a total budgeted cost of \$900.00. The actual cost on completion was \$875.00, showing a saving of \$25.00.
- Further investigations may reveal that the job took 250 man days at a daily rate of \$3.50 - a favourable usage variance but a very unfavourable price variance.
- Management may therefore need to investigate some significant variances revealed by further analysis, which a comparison of the total costs would not have revealed. Price and usage variances for major items of expense are discussed below.



labour

- The difference between actual labour costs and budgeted or standard labour costs is known as direct wages variance. This variance may arise due to a difference in the amount of labour used or the price per unit of labour, i.e. the wage rate. The direct wages variance can be split into:
 - **i) Wage rate variance:** the wage rate was higher or lower than budgeted, e.g. using more unskilled labour, or working overtime at a higher rate.
 - **ii) Labour efficiency variance:** arises when the actual time spent on a particular job is higher or lower than the standard labour hours specified, e.g. breakdown of a machine.



Materials

- The variance for materials cost could also be split into price and usage elements:
- **i) Material price variance:** arises when the actual unit price is greater or lower than budgeted. This could be due to inflation, discounts, alternative suppliers etc.
- **ii) Material quantity variance:** arises when the actual amount of material used is greater or lower than the amount specified in the budget, e.g. a budgeted fertiliser at 350 kg per hectare may be increased or decreased when the actual fertiliser is applied, giving rise to a usage variance.



Overheads

Again, overhead variance can be split into:

- i) Overhead volume variance:** where overheads are taken into the cost centres, a production higher or lower than budgeted will cause an over-or under-absorption of overheads.
- ii) Overhead expenditure variance:** where the actual overhead expenditure is higher or lower than that budgeted for the level of output actually produced.

Calculation of price and usage variances



The price and usage variance are calculated as follows:

Price variance = (budgeted price - actual price) X actual quantity

Usage variance = (budgeted quantity - actual quantity) X budgeted price

Exercise on Computation of labour variances



Exercise on Computation of labour variances

It was budgeted that it would take 200 man days at \$10.00 per day to complete the task costing \$2,000.00 when the actual cost was \$1,875.00, being 150 man days at \$12.50 per day. Calculate:

- i) Price variance
- ii) Usage variance

Comment briefly on the results of your calculation.



Advantages of budgeting and budgetary control

- There are a number of advantages to budgeting and budgetary control:
- Compels management to think about the future, which is probably the most important feature of a budgetary planning and control system. Forces management to look ahead, to set out detailed plans for achieving the targets for each department, operation and (ideally) each manager, to anticipate and give the organisation purpose and direction.
- Promotes coordination and communication.

Advantages of budgeting and budgetary control



- Provides a basis for performance appraisal (variance analysis). A budget is basically a yardstick against which actual performance is measured and assessed. Control is provided by comparisons of actual results against budget plan. Departures from budget can then be investigated and the reasons for the differences can be divided into controllable and non-controllable factors.
- Enables remedial action to be taken as variances emerge.
- Motivates employees by participating in the setting of budgets.
- Improves the allocation of scarce resources.
- Economises management time by using the management by exception principle.



Problems of budgeting

Whilst budgets may be an essential part of any marketing activity they do have a number of disadvantages, particularly in perception terms.

Budgets can be seen as pressure devices imposed by management, thus resulting in:

- a) bad labour relations
- b) inaccurate record-keeping.

Departmental conflict arises due to:

- a) disputes over resource allocation
- b) departments blaming each other if targets are not attained.



Problems of budgeting

- It is difficult to reconcile personal/individual and corporate goals.
- Waste may arise as managers adopt the view, "we had better spend it or we will lose it". This is often coupled with "empire building" in order to enhance the prestige of a department.
- Responsibility versus controlling, i.e. some costs are under the influence of more than one person, e.g. power costs.
- Managers may overestimate costs so that they will not be blamed in the future should they overspend.



Difficulties in budgetary control

(a) Lack of dynamic structure

Present day economic environment demands that organization adapt new and practices. Given the new competitive realities, there is need for management of embrace flexible and adaptable budgetary planning and control system which has the ability to quickly respond to environmental changes and complexities.

A good budgetary planning and control system must involve not only an analysis of capital allocation requests when the project is executed, but also an analysis of all the capital needed to generate information such as market research, prior to investing in the project.



Difficulties in budgetary control

(b) Absence of connection between compensation and financial measures

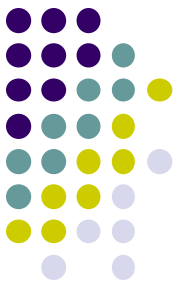
Many companies adopt the NPV criterion in selecting a project but compensate managers based on product earnings or rate of returns. This misaligns their interest with those of shareholders. The reason for misalignment between compensation and budgetary allocation system is that the NPV cannot be used to determine compensation because it (NPV) is a stock/summary measure, based on projected cash flows and not on realized performance. Organisations are expected to adopt flow measures which are computed periodically, either quarterly or yearly as soon as they are realized.



Difficulties in budgetary control

(c) Lack of Integration

Most often, capital budgeting and expense budgeting are distinct processes for instance organizations that do practice capital budgeting make assumptions about future cashflows that are dependent on certain advertising and sales promotion outlays. However, these outlays are typically covered by the expense budget. Boquist noted that even in organizations in which the determination of the expense request is tied at the outset of capital request, the people approving the two requests do not necessarily try to ensure consistency between the two budgets.



Difficulties in budgetary control

(d) Finance function not a strategic partner

Financial analysts doing budgetary planning are often seen as traffic cops than strategic partners. They often get into the budgetary process near the end, merely to rubber-stamp a conclusion that a marketing or manufacturing executive realized earlier. Budgetary planning then becomes a mere exercise, rather than values that produced the desired result, consequently, the quality of information for budgetary planning and control is seriously compromised.



Difficulties in budgetary control

(e) Poorly trained financial professionals

In recent time, training outlays are typically treated as expenses rather than investments (Hope and Frazer, 2003). If the most sophisticated budgetary planning and control system is put in place, absence of the necessary investment in upgrading those involved in budgeting, will only result in expecting to win a battle by sending in people with unfamiliar guns, which all together amount to total failure of such budgeting system (Adedeji, 2004).

END



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Q&A

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FINANCE FUNCTIONS

Dan Chirchir, CFA

Definition

- Finance is the branch of economics that deals with generation and allocation of scarce resources primarily funds or money to the most efficient user or competing projects through a market pricing system.
- It is the application of economic principles and concepts to business decision making and problem solving .

Branches of finance

- Corporate finance/Financial management
- Investment analysis and portfolio management.
- Financial institutions and markets
- Finance theory
- Public finance
- International finance

Financial Management

- Financial Management is nothing but management of the limited financial resources the organisation has, to its utmost advantage.
- Resources are always limited, compared to its demands or needs.
- Financial management deals with the study of procuring funds and its effective and judicious utilisation, in terms of the overall objectives of the firm, and expectations of the providers of funds.
- The basic objective is to maximise the value of the firm. The purpose is to achieve maximisation of share value to the owners i.e. equity shareholders.

Financial Management

The term financial management has been defined, differently, by various authors. Some of the authoritative definitions are given below:

1. “Financial Management is concerned with the efficient use of an important economic resource, namely, Capital Funds” —**Solomon**
2. “Financial Management is concerned with the managerial decisions that result in the acquisition and financing of short-term and long-term credits for the firm” —**Phillioppatus**
3. “Business finance is that business activity which is concerned with the conservation and acquisition of capital funds in meeting financial needs and overall objectives of a business enterprise” —**Wheeler**

Scope of Finance Function

- ❖ **Traditional Approach-Procurement of Funds**
- ❖ **Modern Approach-Effective Utilisation of Funds**

Traditional Approach-Procurement of Funds

- Estimation of requirements of finance,
- Arrangement of funds from financial institutions,
- Arrangement of funds through financial instruments such as shares, debentures, bonds and loans, and
- Looking after the accounting and legal work connected with the raising of funds.

Scope of Finance Function

Limitation of Traditional Approach

- ❖ **No Involvement in Application of Funds:** The finance manager had not been involved in decision-making in allocation of funds. He had been treated as an outsider. He had been ignored in internal decision making process and considered as an outsider.
- ❖ **No Involvement in day to day Management:** The focus was on providing long-term funds from a combination of sources. This process was more of one time happening. The finance manager was not involved in day to day administration of working capital management. Smooth functioning depends on working capital management, where the finance manager was not involved and allowed to play any role.
- ❖ **Not Associated in Decision-Making Allocation of Funds:** The issue of allocation of funds was kept outside his functioning. He had not been involved in decision- making for its judicious utilisation.

Scope of Finance Function

Modern Approach-Effective Utilisation of Funds

- ❖ The emphasis of Financial Management has been shifted from raising of funds to the effective and judicious utilisation of funds.
- ❖ The modern approach is analytical way of looking into the financial problems of the firm.

Objectives of Finance Function

- ❖ **Acquiring Sufficient and Suitable Funds:** The primary aim of finance function is to assess the needs of the enterprise, properly, and procure funds, in time.
- ❖ **Proper Utilisation of Funds:** Raising funds is important, more than that is its proper utilisation. If proper utilisation of funds were not made, there would be no revenue generation. Benefits should always exceed cost of funds so that the organisation can be profitable.

Objectives of Finance Function

- ❖ **Increasing Profitability:** Profitability is necessary for every organisation. The planning and control functions of finance aim at increasing profitability of the firm. To achieve profitability, the cost of funds should be low.
- ❖ **Maximising Firm's Value:** The ultimate aim of finance function is maximising the value of the firm, which is reflected in wealth maximisation of shareholders. The market value of the equity shares is an indicator of the wealth maximisation.

Finance Functions

- ❖ Investment Decision or Long-term Asset mix decision
- ❖ Finance Decision or Capital mix decision
- ❖ Liquidity Decision or Short-term asset mix decision
- ❖ Dividend Decision or Profit allocation decision

Finance Functions

- ❖ Investment Decision or Long-term Asset mix decision
 - **Investment decisions relate to the total amount of assets to be held and their composition in the form of fixed and current assets.** Both the factors influence the risk the organisation is exposed to. The more important aspect is how the investors perceive the risk.
 - The investment decisions result in purchase of assets. Assets can be classified, under two broad categories:
 - (i) Long-term investment decisions – Long-term assets
 - (ii) Short-term investment decisions – Short-term assets

Finance Functions

- ❖ Finance Decision or Capital mix decision
- **Finance decision is concerned with the mix or composition of the sources of raising the funds required by the firm.**
- **In other words, it is related to the pattern of financing.**

Impact of Leverage on Returns

	<u>Firm U</u>	<u>Firm L</u>
EBIT	\$3,000	\$3,000
Interest	<u>0</u>	<u>1,200</u>
EBT	\$3,000	\$1,800
Taxes (40%)	<u>1,200</u>	<u>720</u>
NI	<u><u>\$1,800</u></u>	<u><u>\$1,080</u></u>
ROE	9.0%	10.8%

Why does leveraging increase return?

- More EBIT goes to investors in Firm L.
 - Total dollars paid to investors:
 - U: NI = \$1,800.
 - L: NI + Int = \$1,080 + \$1,200 = \$2,280.
 - Taxes paid:
 - U: \$1,200; L: \$720.
- Equity \$ proportionally lower than NI.

Finance Functions

- ❖ Liquidity Decision or Short-term asset mix decision
 - Liquidity decision is concerned with the management of current assets. Basically, this is Working Capital Management.
 - Working Capital Management is concerned with the management of current assets. It is concerned with short-term survival. Short term-survival is a prerequisite for long-term survival.
 - A proper balance must be maintained between liquidity and profitability of the firm. This is the key area where finance manager has to play significant role. The strategy is in ensuring a trade-off between liquidity and profitability.

Finance Functions

- ❖ Dividend Decision or Profit allocation decision
 - Dividend decision is concerned with the amount of profits to be distributed and retained in the firm.
 - **Dividend:** The term 'dividend' relates to the portion of profit, which is distributed to shareholders of the company. It is a reward or compensation to them for their investment made in the firm. The dividend can be declared from the current profits or accumulated profits.

SEMIs TRAINING

FINANCIAL PLANNING & WORKING CAPITAL MANAGEMENT

Dan Chirchir, CFA, CPA(K)

OUTLINE

- Introduction
- Financial planning process
- Financial forecasting
- Components of financial planning
- Steps in financial planning

FINANCIAL PLANNING

Financial Planning

Introduction

- Financial planning indicates a firm's growth, performance of investments and requirements of funds during a given period of time, usually three to five years.
- It involves the preparation of projected or proforma financial statements, that is statement of financial position, statement of comprehensive income and cash flow statement.
- Financial planning and profit planning help a firm's financial manager to regulate flows of funds which is his primary concern.

Financial Planning Cont'

- Financial planning involves the questions of a firm's long-term growth and profitability and investment and financing decisions
- It focuses on aggressive capital expenditure programmes and debt equity mix rather than the individual projects and sources of finance. Financial planning also involves an interface between the corporate policy and financial planning and the trade off between financial policy variables.

Financial planning process.

The financial planning process involves the following facets;

- Evaluating the current condition of the firm.
- Analyzing the growth prospects and options
- Appraising the investment options to achieve the stated growth objective.
- Projecting the future growth and profitability.
- Estimating funds requirements and considering alternative financial options.
- Comparing and choosing from alternative growth plans and financing options.
- Measuring actual performance with the planned performance.

Financial forecasting

- Financing forecasting is an integral part of financial planning .
- It uses past data to estimate the future financial requirements.
- A financial planning model establishes the relationship between financial variables and targets, and facilitates the financial forecasting and planning process.
- A model makes it easy for the financial managers to prepare financial forecasts. It makes financial forecasting automatic and saves the financial managers time and efforts performing a tedious activity.
- Financial planning models help in examining the consequences of alternative financial strategies.

Components of a financial planning model

- **Inputs**

The model built with the firm's current financial statements and the future growth prospects. The firm's growth prospects depend on the market growth rate, firm's market share and intensity of competition.

- **Model**

The model defines the relationship between financial variables and develops appropriate equations e.g. Relating net working capital and fixed assets investment to sales.

- **Output**

Applying the model equations to the inputs to generate output in the form of projected or proforma financial statements. The output shows the investment and funds requirement given the sales growth objective and relationship between the financial variables.

Steps in financial planning

- Financial forecasting is the basis for financial planning. Forecasts are merely estimates based on the past data. Historical performance may not occur in the future. Planning means what the company would like to happen in future ,and includes necessary action plans to realizing the predetermined intentions.
- The following steps are involved in financial planning;

Steps in financial planning Cont'

Past performance

- ❖ Analysis of the firms past performance to ascertain the relationships between financial variables, and the firms financial strengths and weaknesses.

Operating characteristics

- ❖ Analysis of the firms operating characteristics-product, market, competition, production, and marketing policies, control systems, operating risk etc to decide about its growth objective.

Corporate strategy and investment needs

- ❖ Determining the firms investment needs and choices, given its growth objective and overall strategy.

Steps in financial planning Cont'

Cash flow from operations

- ❖ Forecasting the firms revenues and expenses and need for funds based on its investment and dividend policies.

Financing alternatives

- ❖ Analyzing financial alternatives within its financial policy and deciding the appropriate means of raising funds.

Consequences of financial plans

- ❖ Analyzing the consequences of its financial plans for the long-term health and survival to the firm.

Consistency

- ❖ Evaluating the consistency of financial policies with each other and with the corporate strategy.

Outline

- Introduction
- Core Principles in a nutshell
- Basic Cash flow management
- Cash management
- Inventory Management
- Debtors Management

WORKING CAPITAL MANAGEMENT

Introduction Cont'

Introduction

- Working capital, also known as "WC", is a financial metric which represents operating liquidity available to a business. Along with fixed assets such as plant and equipment, working capital is considered a part of operating capital.
- It is calculated as current assets minus current liabilities. If current assets are less than current liabilities, an entity has a working capital deficiency, also called a working capital deficit.
- Working Capital = Current Assets – Current Liabilities

Introduction Cont'

- A company can be endowed with assets and profitability but short of liquidity if its assets cannot readily be converted into cash. Positive working capital is required to ensure that a firm is able to continue its operations and that it has sufficient funds to satisfy both maturing short-term debt and upcoming operational expenses.
- The management of working capital involves managing inventories, accounts receivable and payable and cash.
- Decisions relating to working capital and short term financing are referred to as working capital management. These involve managing the relationship between a firm's short-term assets and its short-term liabilities.
- The goal of working capital management is to ensure that the firm is able to continue its operations and that it has sufficient cash flow to satisfy both maturing short-term debt and upcoming operational expenses.

Introduction Cont'

- By definition, working capital management entails short term decisions - generally, relating to the next one year period - which is "reversible". These decisions are therefore not taken on the same basis as Capital Investment Decisions (NPV or related) rather they will be based on cash flows and / or profitability.
- One measure of cash flow is provided by the [cash conversion cycle](#) - the net number of days from the outlay of cash for [raw material](#) to receiving payment from the customer. As a management tool, this metric makes explicit the inter-relatedness of decisions relating to inventories, accounts receivable and payable, and cash.
- Because this number effectively corresponds to the time that the firm's cash is tied up in operations and unavailable for other activities, management generally aims at a low net count.

Introduction Cont'

- In this context, the most useful measure of profitability are:
- Return on capital (ROC). The result is shown as a percentage, determined by dividing relevant income for the 12 months by capital employed;
- Return on equity (ROE) shows this result for the firm's shareholders. Firm value is enhanced when, and if, the return on capital, which results from working capital management, exceeds the cost of capital, which results from capital investment decisions as above.
- ROC & ROE measures are therefore useful as a management tool, in that they link short-term policy with long-term decision making.

Introduction Cont'

- Guided by the above criteria, management will use a combination of policies and techniques for the management of working capital.
- These policies aim at managing the current assets (generally cash and cash equivalents, inventories and debtors) and the short term financing, such that cash flows and returns are acceptable.

Core Principles

In a nutshell.....

Cash Management

- Identify the cash balance which allows for the business to meet day to day expenses, but reduces cash holding costs.

Core Principles In a nutshell.....

Inventory Management

- Identify the level of inventory which allows for uninterrupted production but reduces the investment in raw materials - and minimizes reordering costs - and hence increases cash flow;
- Supply chain management;
- Just In Time (JIT);
- Economic order quantity (EOQ);
- Economic production quantity

Core Principles In a nutshell.....

Debtors Management

- Identify the appropriate credit policy, i.e. credit terms which will attract customers, such that any impact on cash flows and the cash conversion cycle will be offset by increased revenue and hence Return on Capital (or vice versa).

Core Principles

In a nutshell.....

Short term Financing

- Identify the appropriate source of financing, given the cash conversion cycle:
 - The inventory is ideally financed by credit granted by the supplier;
 - However, it may be necessary to utilize a bank loan (or overdraft), or to "convert debtors to cash" through "factoring".

Basic Cash Flow Management Cont'

- Managing cash must take an equal stature with Net Income if not higher. In financial management, "cash is king" is a renown motto.
- So your first step in managing cash is to elevate the importance of cash.
- The basic process for managing cash is straightforward. Try to maintain an adequate level of cash to meet current obligations and invest idle cash into earning assets. Earning assets must have high liquidity; i.e. you must be able to convert investments back into cash quickly. Additionally, you want to protect your cash balance by paying obligations only as they come due.
- Managing cash also involves aggressive conversion of current assets into cash.

Basic Cash Flow Management Cont'

- Inventory levels must be converted into accounts receivables and accounts receivables must be converted into cash.
- Ratios should be used to monitor the conversion of cash, such as number of days in inventory and number of days in receivables.
- Cash balances are the end result from a combination of cycles: inventory, purchasing, receivables, payables, etc. The key is to properly manage these cycles for conversion into cash.

Basic Cash Flow Management Cont'

- Once conversion cycles are identified, cash forecasts can be prepared for managing cash. Weekly cash reports are used to monitor balances.
- Since everything ultimately passes through your cash account, a strong internal control system is required.
- This involves the separation of duties in handling cash, reconciling cash accounts, adequate support for cash disbursements, and other control procedures.
- The overall objective is to protect cash just like any other asset through a system of internal controls.

CASH MANAGEMENT

Motives for holding Cash

Transaction motive

- To meet day-to-day commitments the firm needs cash to make payments for purchases ,wages and salaries ,other operating expenses, taxes ,dividends etc.
- The need to hold cash would not arise if there were perfect synchronization between cash receipts and cash payments i.e. enough cash is received when the payment has to be made. But cash receipts and cash payments are not perfectly synchronized.
- Therefore transaction motive mainly refers to holding cash to meet anticipated payments whose timing is not perfectly matched with cash receipts.

Motives for holding Cash Cont'

- **Precautionary motive**

- Holding a balance of cash as future cash flows may be uncertain for any reason.
- It provides a cushion or buffer to withstand some unexpected emergency.
- The precautionary amount depends upon the predictability of cash flows. If cash flows can be predicted with accuracy, less cash will be maintained for an emergency.

Motives for holding Cash Cont

Speculative motive

- Holding cash in order to be in a position to exploit profitable opportunities as and when they arise.
- For instance for investing in profit-making opportunities as and when they arise. The firm will hold cash, when it is expected that interest rates will rise and security prices will fall.

Optimal Cash Balance

- Another aspect of cash management is knowing the optimal cash balance.
- There are a number of methods that try to determine the magical cash balance, which should be targeted so that costs are minimized and yet adequate liquidity exists to ensure bills are paid on time (hopefully with something left over for emergency purposes).
- One of the first steps in managing the cash balance is measuring liquidity. There are numerous ways to measure this, including:
 - Cash to total assets ratio;
 - Current ratio (current assets divided by current liabilities);
 - Quick ratio (current assets less inventory, divided by current liabilities), and;
 - The net liquid balance (cash plus marketable securities less short-term notes payable, divided by total assets).

Optimal Cash Balance Cont.'

- The higher the number generated by the liquidity measure, the greater the liquidity and vice versa.
- There is a trade off, however, between liquidity and profitability that discourages firms from having excessive liquidity.

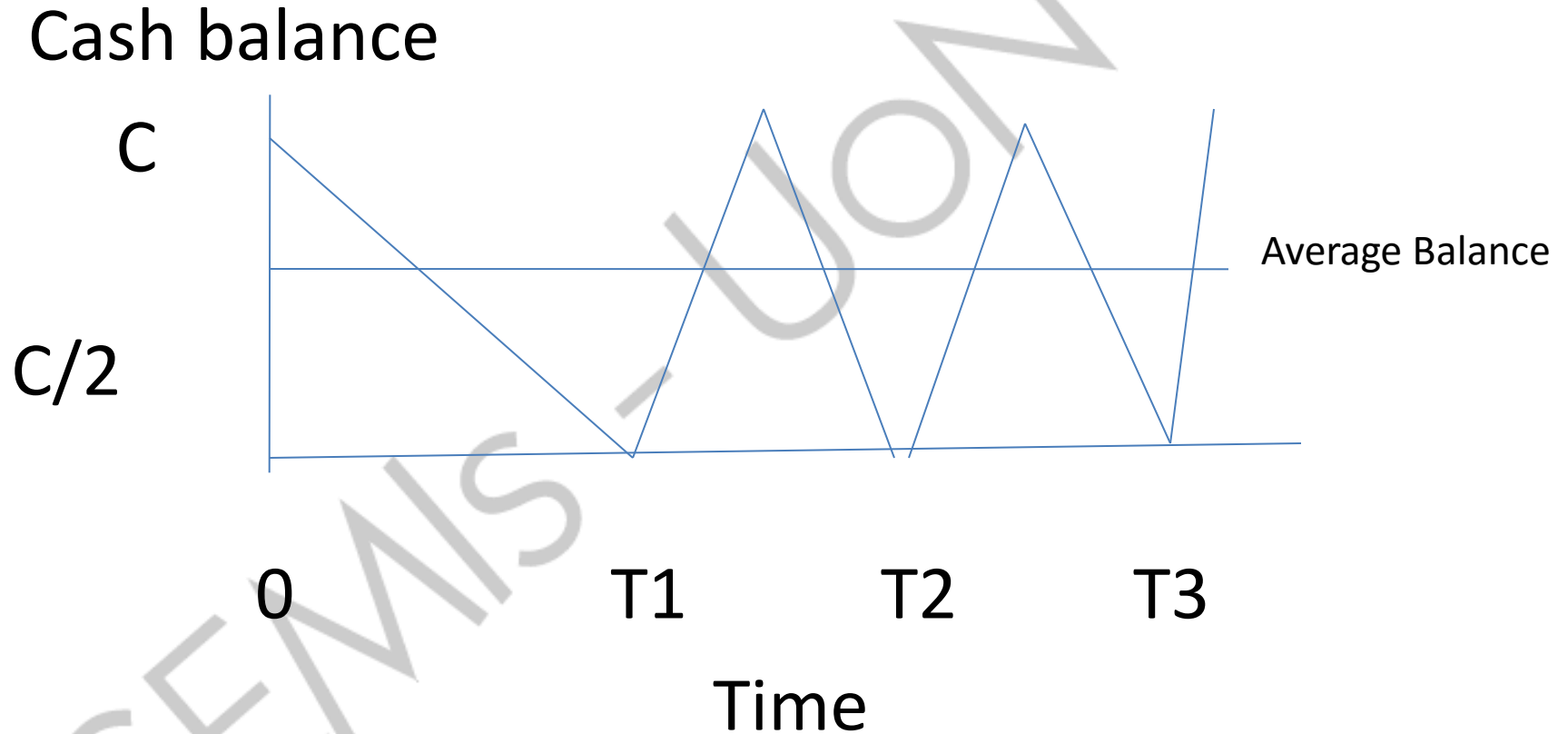
Cash Management Models

- To help manage cash on a day-to-day basis in actual dollars and cents, there are a number of cash management models.
- These include the:
 - Baumol Model,
 - Miller-Orr Model, and
 - Stone Model.

Baumol Model.

- The Baumol's model of cash management provides a formal approach for determining a firm's optimum cash balance under certainty. The firm attempts to minimize the sum of the cost of holding cash (inventory of cash) and the cost of converting marketable securities to cash.
- The model makes the following assumptions.
 - The firm is able to forecast its cash needs with certainty.
 - The firm's cash payments occur uniformly over a period of time.
 - The opportunity cost of holding cash is known and it does not change over time.
 - The firm will incur the same transaction cost whenever it translates securities to cash.

Baumol Model Cont.'

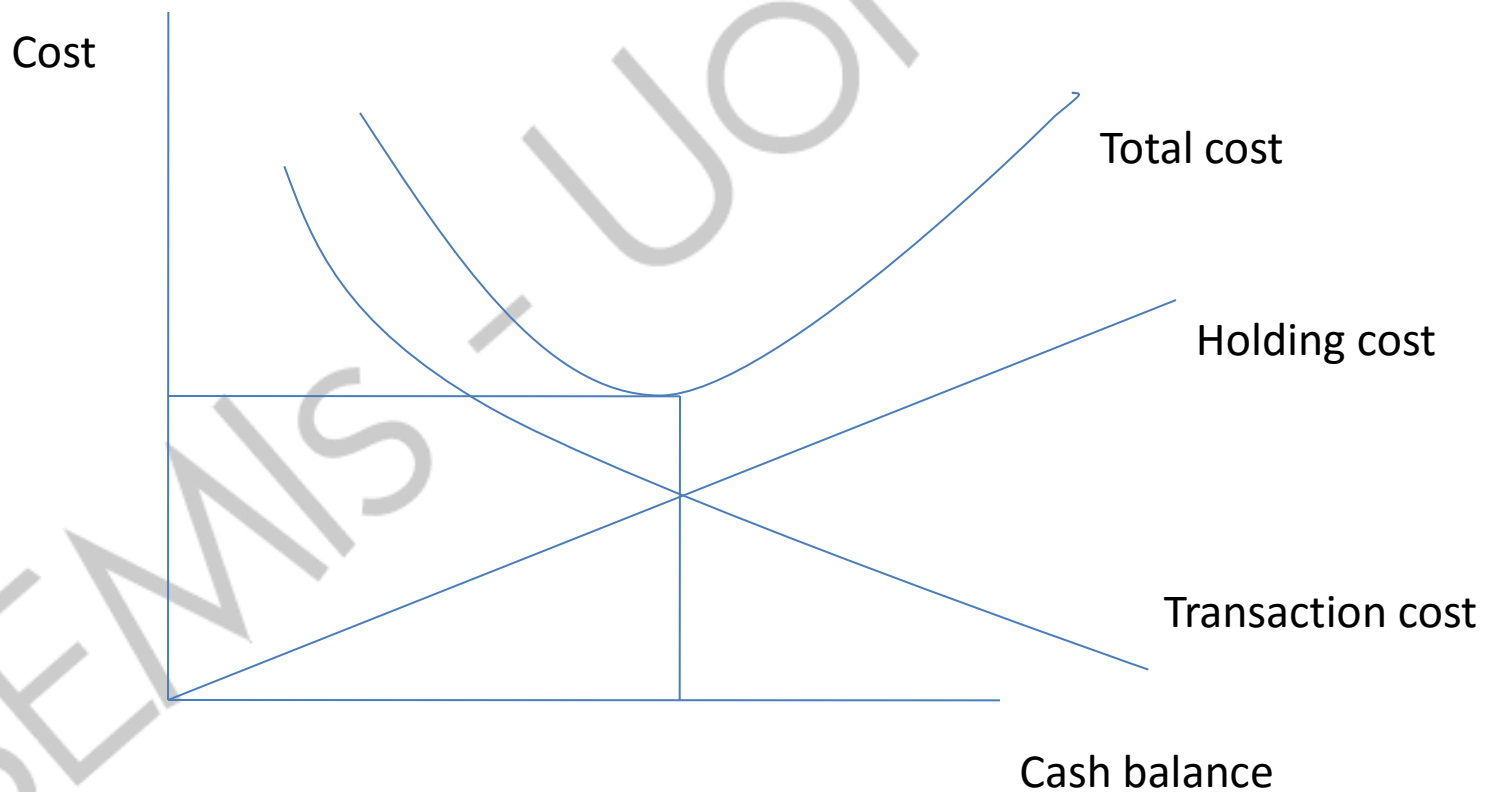


Baumols model Cont.'

- Assuming that the firm sells securities and starts with cash balance of shs. C as the firm spends cash, its cash balance decreases steadily and reaches zero. The firm replenishes its cash balance to shs. C by selling marketable securities.
- This pattern continues over time. Since the cash balance decreases steadily, the average cash balance will be; $C/2$.

Baumols model Cont.'

- Optimal Cash Balance



Baumols model Cont.'

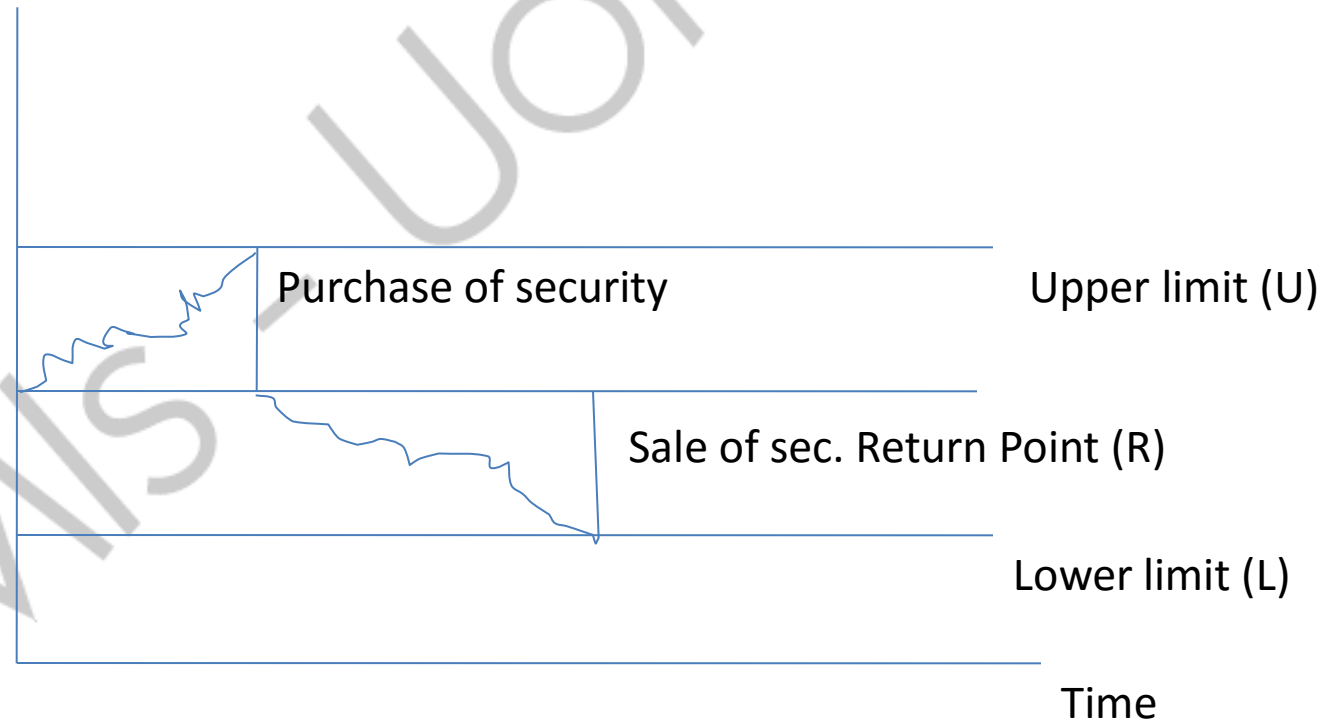
- The firm incurs a holding cost for keeping the cash balance. It is an opportunity cost; that is the return foregone on the marketable securities. Transaction cost is incurred whenever the firm converts its marketable securities to cash. Total cost comprise holding and transaction costs.
- Holding costs increase as demand for cash, C , increases. However, the transaction cost reduces because with increasing cash the number of transactions will decline.
- Therefore the optimal cash balance is obtained when the total cost is minimum.
- One shortcoming of this model is that it accommodates only a net cash outflow situation as opposed to both inflows and outflows. Also, the cash outflow is at a constant rate, with no variation.

Miller-orr Model.

- The Miller-Orr Model rectifies some of the deficiencies of the Baumol Model by accommodating a fluctuating cash flow stream that can be either inflow or outflow. The Miller-Orr Model has an upper limit U and lower limit L
- When there is too much cash and U is reached, cash is taken out (to buy short-term [securities](#) to earn interest) such that the cash balance goes to a return (R) point. Otherwise, if there is too little cash and L is reached, cash is deposited (from the short-term investments) to replenish the balance to R .

Miller-orr Model Cont.'

Cash balance



Miller-Orr model

Miller-orr Model Cont.'

- L is determined by other means, for example, compensating balance requirement, minimum balance to avoid bank service charges on checking account, or zero.

SEMS -

The Miller-Orr Model

- Target Cash Balance (Z)

$$Z = \sqrt[3]{\frac{3 \times TC \times V}{4 \times r}} + L$$

where: **TC** = transaction cost of buying or selling securities

V = variance of daily cash flows

r = daily return on short-term investments

L = minimum cash requirement

The Miller-Orr Model

- Target Cash Balance (Z)

- Example: Suppose that short-term securities yield 5% per year and it costs the organization \$50 each time it buys or sells securities (TC). The daily variance of cash flows is \$1000 (V) and your bank requires \$1,000 minimum checking account balance (L).*

$$Z = \sqrt[3]{\frac{3 \times 50 \times 1000}{4 \times .05/360}} + \$1,000$$
$$= \$3,000 + \$1,000 = \$4,000$$

The Miller-Orr Model

- Upper Limit

- The upper limit for the cash account (H) is determined by the equation:

$$H = 3Z - 2L$$

where:

Z = Target cash balance

L = Lower limit

- In the previous example:

$$H = 3 (\$4,000) - 2(\$1,000) = \$10,000$$

Stone Model

- The Stone Model is somewhat similar to the Miller-Orr Model insofar as it uses control limits. It incorporates, however, a look-ahead forecast of cash flows when an upper or lower limit is hit to take into account the possibility that the surplus or deficit of cash may naturally correct itself.
- If the upper control limit is reached, but is to be followed by cash outflow days that would bring the cash balance down to an acceptable level, then nothing is done.
- If instead the surplus cash would substantially remain that way, then cash is withdrawn to get the cash balance to a predetermined return point.
- Of course, if cash were in short supply and the lower control limit was reached, the opposite would apply. In this way the Stone Model takes into consideration the cash flow forecast.

Conclusion on the cash models

- The goals of these models are to ensure adequate amounts of cash on hand for bill payments, to minimize transaction costs in acquiring cash when deficiencies exist, and to dispose of cash when a surplus arises.
- These models assume some cash flow pattern as a given, leaving the task of cash collection, concentration, and disbursement to other methods.

Investing of surplus cash

Short-term investment decisions

- Consider:
 - Return
 - Liquidity
 - Default risk

Short term investment opportunities may include the following

- Treasury bills
- Commercial papers
- Certificates of deposits
- Inter-corporate deposits
- Money market mutual funds

INVENTORY MANAGEMENT

Introduction

Nature of inventories

- Inventories are stock of the product a company is manufacturing for sale and components that make up the product.
- The various forms in which inventories exist in a manufacturing company are

Introduction Cont.'

- **Production supply (raw materials)** – the initial inputs into the production process that are converted into finished product through the manufacturing process.
- **Work- in-process process (semi-finished goods)** items beyond the raw material stage but not yet at the completed product stage. They represent products that need more work before they become finished products for sale.
- **Finished goods** – completed goods which are ready for sale.

Motives for holding inventories

There are three general motives for holding inventories

- ***Transaction motive***

Emphasizes the need to maintain inventories to facilitate smooth production and sales operations.

- ***Precautionary motive***

Necessitates holding of inventories to guard against the risk of unpredictable changes in demand and supply forces and other factors.

- ***Speculative motive***

Influences the decision to increase or reduce inventory levels to take advantage of price fluctuations.

Objectives of inventory management

In the context of inventory management ,the firm is faced with meeting two conflicting needs :

- To maintain a large size of inventories of raw material and work in progress for efficient and smooth production and of finished goods for uninterrupted sales operations.
- To maintain a minimum investment in inventories to maximize profitability.

Note

- ❑ Both excessive and inadequate inventories are not desirable. The objective of inventory management should be to determine and maintain optimum level of inventory investment.

Major dangers of over investment

- Unnecessary tie-up of the firm's funds and loss of profit. The excessive level of inventories consumes funds of the firm, which cannot be used for any other purpose, and, thus it involves an opportunity cost.
- Excessive carrying costs. The carrying costs, such as the costs of storage, handling, insurance, recording and inspection also increase in proportion to the volume of inventory.
- Risk of liquidity. Problems of liquidity may arise due to the fact that it may not be possible to dispose excess inventory in time and at full value.

Downside of under-investment in inventories

- Production hold-ups-Inadequate raw materials and work in progress inventories will result in frequent production interruptions.
- Failure to meet delivery commitments. If finished goods inventories are not sufficient to meet the demand for customers regularly, they may shift to competitors, which will amount to permanent loss to the firm.

Basic principles of inventory Mgt.

A firm should, therefore, attempt to maintain an optimum level of inventory. For effective management of inventory, a firm should;

- Plan its production and estimate its raw materials requirement accordingly
- Not only consider production plans, but also other factors such as usage, supply delays etc in deciding upon the level of raw material inventory.
- Start control of inventories with the purchase of raw materials since after commitment to purchase has been made or raw material has been actually purchased, there can be very little control.

Basic principles of inventory Mgt.

- Decide about the level of finished goods inventory ,keeping in mind customers demand ,periods of peak demand ,costs of lost sales ,competitors polices etc
- Minimize cost of holding inventories, subject to production and sales plans
- Identify the most critical items of inventories and devote maximum attention in their control
- Achieve inventory control through concerted efforts by involving purchase, production marketing and finance executives.
- Develop a proper reporting system for inventory control. Slow moving inventories must be highlighted and immediate action initiated to redeem the situation.

Controlling Inventory

Inventory size

- Control of inventories starts with the purchase of raw materials and the quantity of raw material to be ordered and the timing of the purchase are critical for this.
- Ordering costs-include costs of requisition, placing of order, freight charges, receiving, inspecting and storing of goods, accounting administrative costs etc
- Most of these costs increase with the number of orders.
- Carrying costs or holding costs-are incurred to maintain inventories. They include costs of storing, handling insurance, deterioration in storage, administration etc
- Carrying costs vary with levels of inventory.

- A firm should order only a quantity of materials which minimizes the total of ordering and carrying costs.

Illustration.

ABC Company projects annual requirement of one item of material at 60,000 units. The purchase price per unit is kshs.55. Ordering cost per order is kshs.100 and carrying cost per unit is kshs.0.48.

Required

- How many units should the company order?

Solution

- Let us calculate total ordering and carrying costs for different numbers of orders, say, 1, 4, 5, 6, 12, 15, and 20

No. of orders	1	4	5	6	12	15	20
Order Size	60,000	15,000	12,000	10,000	5,000	4,000	3,000
Avg. Inventory	30,000	7,500	6,000	5,000	2,500	2,000	1,500
Carrying Costs	14,400	3,600	2,880	2,400	1,200	960	720
Ordering costs	100	400	500	600	1,200	1,500	2,000
Total Costs	14,500	4,000	3,380	3,000	2,400	2,460	2,720

Solution, Cont.'

- The total costs are minimum when the company places orders in the lots of 5,000 each i.e 12 orders in a year.
- Average inventory is calculated as half of the inventory acquired in the beginning on the assumption that inventories will be evenly used up during the period.

Economic Order Quantity (EOQ)

- EOQ: It is the order size at which total carrying and ordering costs are minimum.
- The economic order quantity can readily be calculated by using the following formula:

$$EOQ = \sqrt{\frac{2 \cdot A \cdot O}{C}}$$

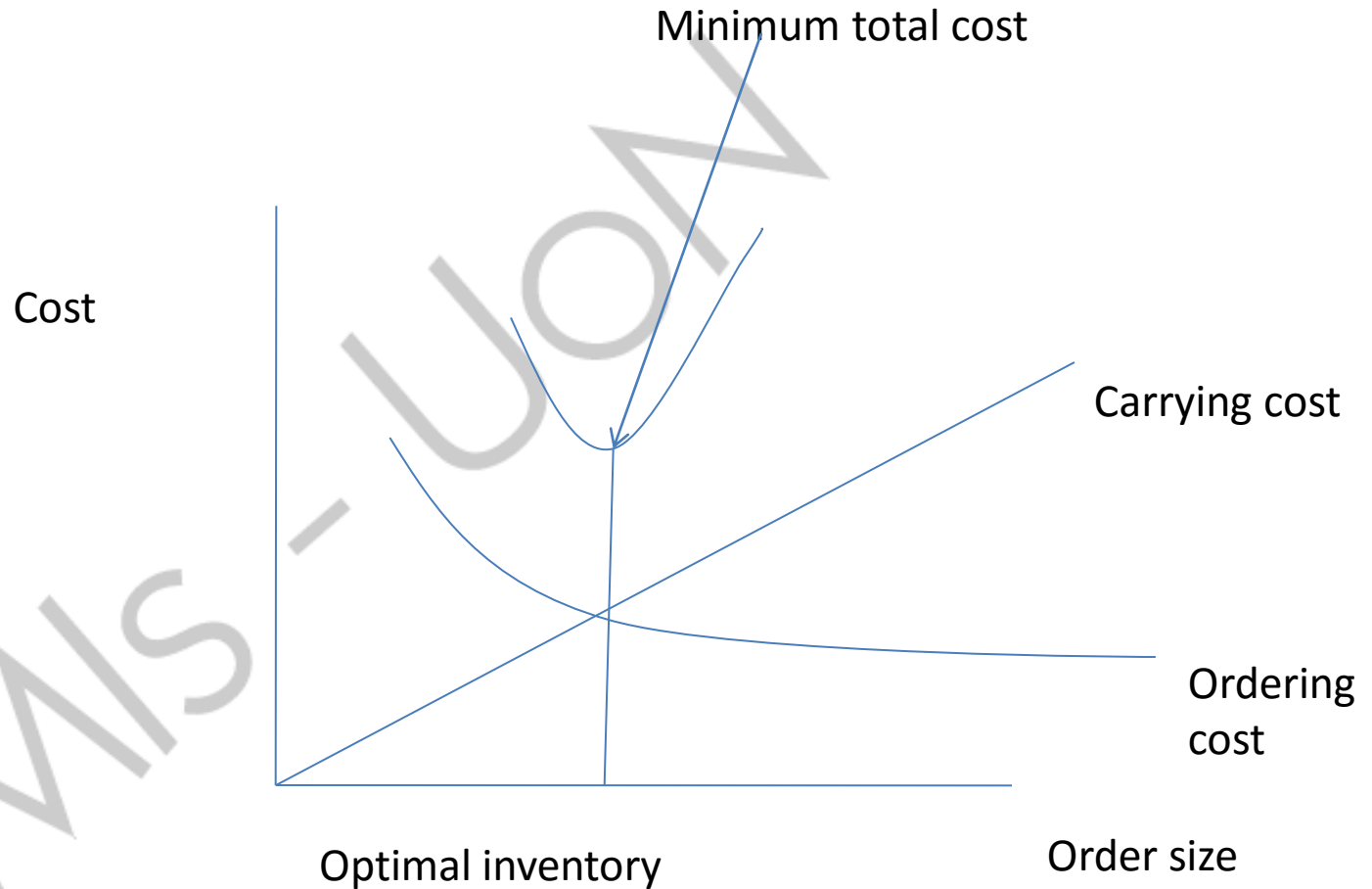
- Where;
 - O-is the ordering cost
 - A-total annual requirements and
 - C-is the carrying cost.

EOQ: Illustration

- Suppose the estimated production requirement is 1200 units, ordering cost per order is kshs.37.5 and carrying cost per unit is shs.1.
- The economic order quantity will be:

$$\begin{aligned} \text{EOQ} &= \sqrt{\frac{2 \times 1200 \times 37.5}{1}} \\ &= 300 \text{ units} \end{aligned}$$

Optimal Inventory



The Cost of Financing Inventories

- Inventory financing can be used where inventories are highly marketable and no threat of obsolescence exists. The inventory serves as collateral within the financing arrangement. Financing can occur up to 70% of inventory values provided that inventory prices are relatively stable. The costs of financing inventory can be very high; such as 6% over the prime lending rate.
- Three types of financing arrangements for inventory are available. They are floating liens, warehouse receipts, and trust receipts. Floating liens place a lien on the overall inventory stock. Warehouse receipts give the lender an interest in your inventory.
- And trust receipts represent a loan which is released as you sell your inventory.

Illustration

- You would like to finance kshs. 100,000 of your inventory. You need the funds for 3 months. You will use a warehouse receipt arrangement. This arrangement requires that you setup a separate area for the lender's inventory. You estimate an additional kshs. 2,000 in costs for storing and maintaining the inventory. The lender will advance you 80% at 16%.
- The cost of financing inventory is kshs. 5,200 as calculated below:
 - $0.16 \times 0.80 \times \text{shs } 100,000 \times 3/12 = \text{shs } 3,200 + \text{shs } 2,000$
or Sh. 5,200.

RECEIVABLES MANAGEMENT

Introduction

- In literature also referred to as credit management, management of debtors.
- Cash flow is greatly affected by the policies established by a company with regard to:
 - The choice of customers,
 - The way in which sales are made,
 - The sales invoicing system,
 - The speedy correction of errors and resolution of disputes,
 - The means of settlement,
 - The monitoring of customer settlement performance,
 - The overdue accounts collection system.

Why do firms grant credit?

Companies in practice feel the necessity of granting credit for several reasons ;

- ***Competition***

Generally the degree of competition, the more the credit granted by a firm

- ***Company's bargaining power***

If a company has a higher bargaining power vis-à-vis its buyers, it may grant no or less credit.

- ***Buyers requirements***

In a number of business sectors buyers /dealers are not able to operate without extended credit.

- ***Buyers status***

Large buyers demand easy credit terms because of bulk purchases and higher bargaining power.

Why do firms grant credit? Cont.'

- ***Relationship with dealers***

Companies sometimes grant credit to dealers to build long-term relationships with them or to reward them for their loyalty.

- ***Marketing tool***

Credit is used as a marketing tool, particularly when a new product is launched or when a company wants to push its weak product.

- ***Industry practice***

Small companies have been found to be guided by industry practice norm more than the large companies.

- ***Transit delays***

This is a forced reason for the case of extended credit in the case of a number of firms. This is done to minimize delays.

Credit policy

- The term credit policy is used to refer to three decision variables
 - Credit standards
 - Credit terms
 - Collection policy and procedures.
- The credit manager may administer the credit policy of the firm. It should however be appreciated that credit policy has important implications for the firms production, marketing, and finance functions. Therefore it is advisable that a committee that consists of the executives of production, marketing and finance departments formulates the firm's credit policy.

Credit policy Cont.'

- Under this, the financial or credit manager should ensure that the firm's value of the share is maximized. He does by answering the following questions.
- What will be the change in sales when a decision variable is altered?
- What will be the cost of altering the decision variable?
- How would the level of the receivable be affected by changing the decision variable?
- How are expected rate of return and cost of funds related?

Credit standards.

- Credit standards are the criteria which a firm follows in selecting customers for credit extension.
- The firm may have tight credit standards, that is, it may sale mostly on cash basis, and may extend credit only to the most reliable and financially strong customers.
- Such standards will result in no bad debt losses, and; less cost of credit administration. But the firm may not be able to expand sales.
- The profit sacrificed on lost sales may be more than the costs saved by the firm.
- On the contrary if credit standards are loose the firm may have larger sales .but the firm will have to carry a larger receivable.

Credit analysis

Credit standards influence the quality of the firms customers .there are two aspects of the quality of the customers;

- The time taken by customers to repay credit obligation. The average collection period determines the speed of payments by customers. it measures the number of days credit sales remain outstanding.
- The default rate-can be measured in terms of bad debt-losses ratio. The proportion of uncollected receivable. Bad debts ratio indicates default risk.

Credit evaluation

Proper assessment of credit risks is an important element of credit management. It helps in establishing credit limits. In assessing credit risks, two types of errors occur;

- Type I error- a good customer is classified as a poor credit risk
- Type II error –a bad customer is misclassified as a good credit risk.
- Both the errors are costly. Type I error leads to loss of profits on sales to good customers who are denied credit. Type II error results in bad debt losses on credit sales made to risky customers.
- While misclassification errors cannot be eliminated fully, the firm can mitigate their occurrence by doing proper credit evaluation, through:
 - Traditional credit analysis;
 - Numerical credit scoring.

Traditional credit analysis

- The traditional approach to credit analysis calls for assessing the customer in terms of the “five Cs of credit”
- **Character**
The willingness of the customer to honor his obligations. It reflects integrity, a moral attribute that is considered very important by credit managers.
- **Capacity**
The ability of the customer to meet his obligations from the operating cash flows.
- **Capital**
The financial reserves of the customer. If the customer has problems in meeting credit obligations from operating cash flow, the focus shifts to its capital.
- **Collateral**
The security offered by the customer in the form of pledged assets
- **Conditions**-Macroeconomic environment

The general economic conditions that affect the customer

- To get the information on the five Cs a firm may rely on the following;

- Financial statements

A searching analysis of the customers' financial statements can provide useful insights into the credit worthiness of the customer.

- Bank references

The banker of the prospective customer may be another source of information. To ensure a higher degree of candor, the customer's banker may be approached indirectly through the firm granting credit.
Credit Reference Bureaus

The general economic conditions that affect the customer Cont.'

- Experience of the firm
- Consulting ones own experience is very important .if the firm had previous dealings with the customer, then it is worth asking; how prompt has the customer been in making payments?
- Prices and yields on securities
- For listed companies, valuable references can be derived from market data. Higher the price –earning s multiple and lower the yield on bonds, other things being equal, lower will be the credit risk.

Numerical credit scoring

The system involves the following steps

- Identify the factors relevant for credit evaluation
- Assign weights to these factors that reflect their relative importance
- Rate the customer on various factors ,using a suitable rating scale (usually a 5-point scale or a 7-point scale is used)
- For each factor ,multiply the factor rating with the factor weight to get the factor score
- Add all the factor scores to get the customer rating index
- Based on the rating index, classify the customer

Construction of a credit rating index.

(Based on a 5-point rating scale)

Illustration

<i>Factor</i>	<i>Weight</i>	<u><i>Rating</i></u>					<i>Factor score</i>
		5	4	3	2	1	
Past payment	0.30			x			1.2
Net profit margin	0.20			x			0.8
Current ratio	0.20				x		0.6
Debt-equity ratio	0.10			x			0.4
Return on equity	0.20	x					<u>1.0</u>
							Rating index
							4.00

Control of accounts receivable

- Methods used
 - Days sales outstanding
 - Ageing schedule

Day's sales outstanding

- The days sales outstanding (DSO) at a given time t , may be defined as the ratio of accounts receivable outstanding at that time to average daily sales figure during the preceding 30 days, 60 days, 90 days or some other relevant period.
- $DSO_t = \frac{\text{accounts receivable at time } t}{\text{Average daily sales}}$

Illustration

Consider the monthly sales and month-end accounts receivable for ABC Company for the two quarters of the year

Month	sales (shs)	receivables (shs)
January	150	400
February	156	360
March	158	320
April	190	310
May	170	300
June	180	320

Required

DSO for each quarter

Solution

$$\begin{array}{l} \text{Quarter 1} \\ \text{DSO} \\ \text{days} \end{array} \frac{320}{(150 + 156 + 158) / 90} = 62$$

Ageing schedule

The ageing schedule classifies outstanding accounts receivables at a given point of time into different age brackets

Illustration

<u>Age group (in days)</u>	<u>percent receivables</u>
0-30	35
31-60	40
61-90	20
>90	5

Policies of trade credit

When offering to sell on credit, the business must have policies concerning:

- Which customers should receive credit?
- How much credit should be offered,
- What length of credit it is prepared to offer,
- Whether discounts will be offered for prompt payment,
- What collection policies should be adopted,
- How the risk of non-payment can be reduced.

Policies of trade credit Cont.'

Phases of decision-making in management of receivables

- Decision on offering trade credit

Initial phase of management of receivables (who to grant credit to, how much, for how long) –establishing credit policy containing general guidelines then used by various managers

- Management and monitoring the receivables balance

Phase containing methods, procedures, steps to ensure that amounts owing are collected as quickly as possible

Policies of trade credit Cont.'

Steps to ensure that amounts owing are collected as quickly as possible

- Publicize credit terms
- Issue invoices promptly
- Monitor outstanding debts
- Produce an ageing schedule of debtors
- Identify the pattern of receipts
- Answer queries quickly
- Deal with slow payers
- Reducing the risk of non-payment
- Advance payments,
- Offset amounts owed against amounts due,
- Requiring a third-party guarantee

Policies of trade credit Cont.'

- legal title of the goods is not passed to the customer until they are paid for,
- Insurance to cover the costs of any legal expenses incurred in recovering debt,
- Insurance against the risk of non-payment

Conclusion

COST OF HIGH LEVEL WORKING CAPITAL

- **Debtors/receivables**

- Ties cash in debtors-the firm may be forced to borrow to continue operating
- Credit/default risk
- High collection costs

- **Cash**

- Opportunity cost of not investing excess cash
- Risk of fraud and theft

Conclusion

COST OF HIGH LEVEL WORKING CAPITAL

- **Inventory**

- Unnecessary tie-up of the firm's funds and loss of profit. The excessive level of inventories consumes funds of the firm, which cannot be used for any other purpose, and, thus it involves an opportunity cost.
- Excessive carrying costs. The carrying costs, such as the costs of storage, handling, insurance, recording and inspection also increase in proportion to the volume of inventory.
- Risk of liquidity. Problems of liquidity may arise due to the fact that it may not be possible to dispose excess inventory in time and at full value.
- Obsolescence risk

Conclusion

COST OF LOW LEVEL WORKING CAPITAL

- **Debtors/Receivables**

- Loss of customers hence reduced revenue
- Loss of competitiveness

- **Cash**

- Low liquidity
- Inability to deal with emergency cases

Conclusion

COST OF LOW LEVEL WORKING CAPITAL

- **Inventory**

- ❑ Production hold-ups-Inadequate raw materials and work in progress inventories will result in frequent production interruptions.
- ❑ Failure to meet delivery commitments. If finished goods inventories are not sufficient to meet the demand for customers regularly, they may shift to competitors, which will amount to permanent loss to the firm.

Dan chirchir, CFA
School of business
University of nairobi

END

Email: dchirchir@uonbi.ac.ke

SEMIS

Investment Decisions/Capital Budgeting

Dan Chirchir, CFA, CPA(K)

Introduction

Definition

- ❖ Capital Budgeting is the process of identifying and evaluating capital projects, that is projects where the cash flow to the firm will be received over a period longer than a year.
- ❖ Decisions about whether to buy a new machine, expand business in a another geographic area, replace delivery truck etc can be examined using capital budgeting analysis

Steps in capital budgeting

Administrative steps..

- ❖ Idea generation
- ❖ Analysing project proposal
- ❖ Create firm-wide capital budget-through prioritising projects
- ❖ Monitoring decisions and conducting post-audit

Categories of capital budgeting projects

- ❖ Replacement projects to maintain the business
- ❖ Replacement projects for cost reductions
- ❖ Expansion projects
- ❖ New product or market development
- ❖ Mandatory projects- eg safety related or environmental projects
- ❖ Other projects

Principles of capital budgeting

- ❖ Decisions are based on cash flows, not accounting income: Relevant cash flows include incremental cash flows
- ❖ Cash flows are based on opportunity costs
- ❖ The timing of cash flows is important
- ❖ Cash flows are analysed on an after-tax basis
- ❖ Financing costs are reflected in the project's required rate of return

Key terminologies

- ❖ Independent vs Mutually exclusive projects
- ❖ Unlimited Funds vs. Capital Rationing

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Techniques

- ❖ Pay back period
- ❖ Discounted Pay back period
- ❖ Net Present Value (NPV)
- ❖ Profitability Index
- ❖ Internal Rate of return (IRR)
- ❖ Modified Internal Rate of Return (MIRR)

Pay Back Period (PBP)

Pay back period:

Is the number of years it takes to recover the initial cost of investment.

Decision Rule:

Independent project

Accept Project: If the PBP is less than the one set by the firm.

Reject Project: If the PBP is greater than the one set by the firm.

Pay Back Period (PBP)

Decision Rule:

Mutually exclusive project

Accept Project: With the Shortest PBP

Reject Project: All other projects

Advantages:

- ✓ Simple
- ✓ Good measure of project liquidity
- ✓ Cost effective

Disadvantages

- ✓ Does not consider time value of money
- ✓ Does not consider cash flows beyond the pay back period
- ✓ The target PBP of the firm is arbitrarily set

Discounted Pay Back Period (DPBP)

Discounted Pay back period:

Uses present values of the project's estimated cash flows. It is the number of years it takes a project to recover its initial investment in present value terms

Decision Rule:

Independent project

Accept Project: If the PBP is less than the one set by the firm.

Reject Project: If the PBP is greater than the one set by the firm.

Discounted Pay Back Period (PBP)

Decision Rule:

Mutually exclusive project

Accept Project: With the Shortest PBP

Reject Project: All other projects

Advantages:

- ✓ Simple
- ✓ Good measure of project liquidity
- ✓ Cost effective
- ✓ It considers time value of money

Disadvantages

- ✓ Does not consider cash flows beyond the pay back period
- ✓ The target PBP of the firm is arbitrarily set

Net present Value (NPV)

NPV:

It is the sum of the present values of all the expected incremental cash flows if a project is undertaken. The discount rate is the firm's cost of capital, adjusted for the risk level of the project.

Decision Rule:

Independent project

Accept Project: If NPV is greater than zero

Reject Project: If NPV is less than zero

NPV

Decision Rule:

Mutually exclusive project

Accept Project: The highest NPV

Reject Project: All other projects

Advantages:

- ✓ True measure of profitability
- ✓ Considers all cash flows
- ✓ It considers time value of money

Disadvantages

- ✓ It is difficult to accurately estimate the cost of capital

Profitability Index (PI)

PI:

It is the Present value of a project's future cash flows divided by the initial cash outlay.

Decision Rule:

Independent project

Accept Project: If PI is greater than one

Reject Project: If PI is less than one

PI

Decision Rule:

Mutually exclusive project

Accept Project: The highest PI

Reject Project: All other projects

Advantages:

- ✓ True measure of profitability
- ✓ Considers all cash flows
- ✓ It considers time value of money
- ✓ Can be used to rank projects under capital rationing environment

Disadvantages

- ✓ It is difficult to accurately estimate the cost of capital

IRR

IRR:

It is the discount rate that makes the present value of the expected incremental cash flows just equal to the initial cost of the project.

It is the discount rate that makes the present value of the project's estimated cash inflows equal to the present value of the project's estimated cash flows .

Decision Rule:

Independent project

Accept Project: If IRR is greater than cost of capital

Reject Project: If IRR is less than cost of capital

IRR

Decision Rule:

Mutually exclusive project

Accept Project: The highest IRR

Reject Project: All other projects

Advantages:

- ✓ True measure of profitability
- ✓ Considers all cash flows
- ✓ It considers time value of money

Disadvantages

- ✓ No IRR
- ✓ Multiple IRR

Example

The following tables shows the cash flows of two projects. The cost of capital is 10%.

Year	Project A	Project B
0	(750)	(750)
1	500	100
2	400	(300)
3	(300)	400
4	200	675
5	200	200
6	200	100

Example Cont'

Required

Compute:

- ❖ Pay back period
- ❖ Discounted Pay back period
- ❖ Net Present Value (NPV)
- ❖ Profitability Index
- ❖ Internal Rate of return (IRR)
- ❖ Modified Internal Rate of Return (MIRR)

Advise on which project to select if (i) Projects are Independent projects (ii) Mutually exclusive

Example Cont'

$$\text{IRR} = \text{Lr} + \frac{\text{Positive NPV}}{\text{Positive NPV} - \text{Negative NPV}} * (\text{Hr} - \text{Lr})$$

- By Henrick Ondigo

SEMS - UON



Contents

- 1. Understanding Financial Statements***
- 2. Business Forecasting, Profitability & Cash Flow Management***



UNDERSTANDING FINANCIAL STATEMENTS

**A SEED AND ENTERPRISE INSTITUTE
(SEMI_s) COURSE PRESENTATION.**

BY

HERICK ONDIGO

SCHOOL OF BUSINESS, UoN

JULY 2015





OBJECTIVES

- At the end of the presentation , you should:
- Explain the functions and importance of accounting, and identify the three basic activities involving accounting
- Discuss Why you need financial statements
- State What financial statements you need
- Discuss how financial ratios are used to analyze a company's financial strengths and weaknesses.
- Describe the role of budgets in a business.
- Appreciate the need for understanding financial statements



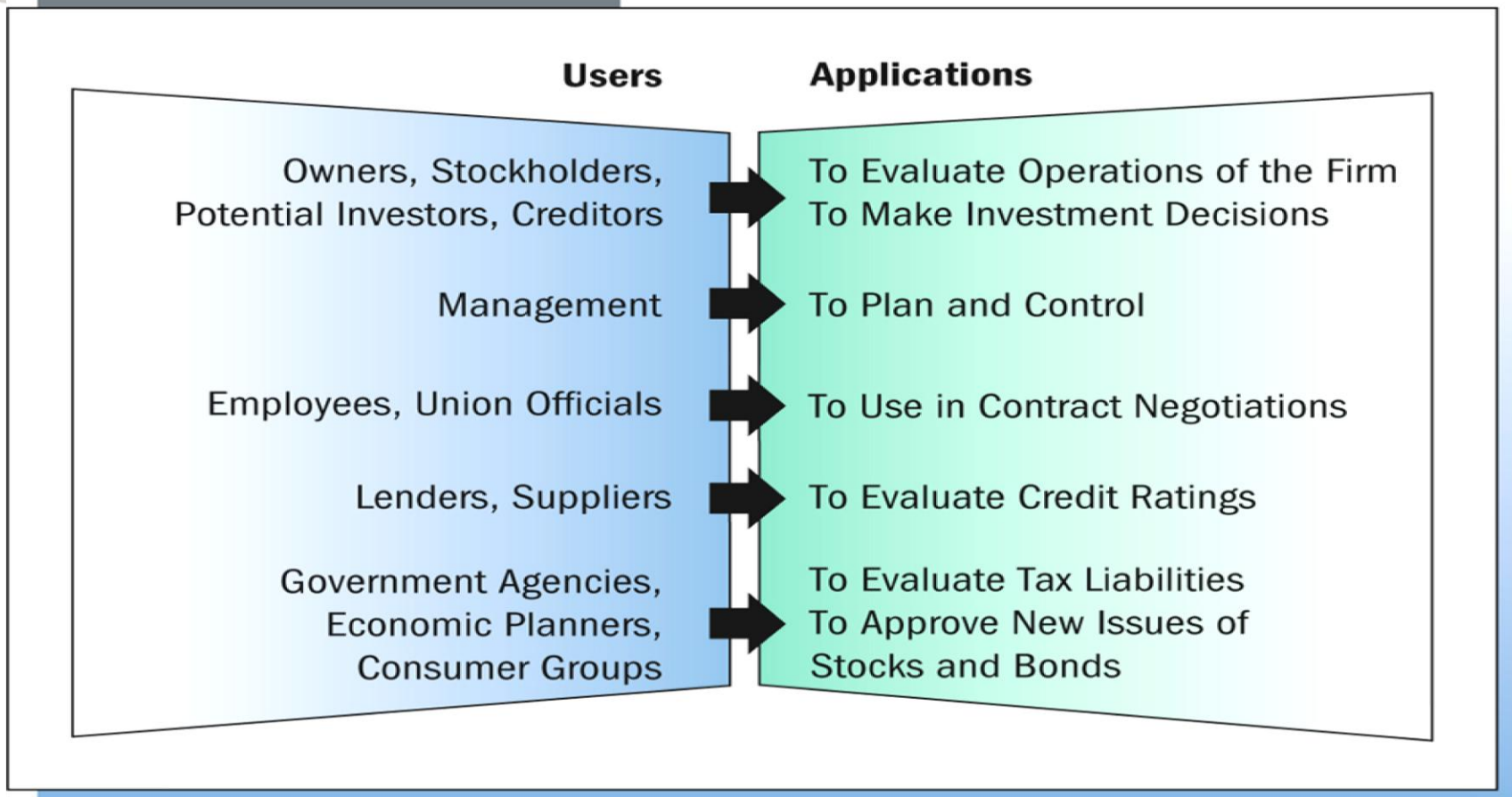
Accounting-Defined

- Accounting is the process of measuring, interpreting, and communicating financial information to support internal and external business decision making.

Users of accounting information

Figure 16.1

Users of Accounting Information



Business Activities Involving Accounting

- **Financing** activities provide necessary funds to start a business and expand it after it begins operating.
- **Investing** activities provide valuable assets required to run a business.
- **Operating** activities focus on selling goods and services, but they also consider expenses as important elements of sound financial management.

The Accounting Cycle

- ***Accounting process*** – set of activities involved in converting information about transactions into financial statements

The Accounting Cycle

Figure 16.2

The Accounting Cycle

Basic Data

Transactions

Receipts, invoices, and other source documents related to each transaction are assembled to justify making an entry in the firm's accounting records.

Processing

Record

Transactions are recorded, usually electronically, in chronological order in books called journals, along with a brief explanation for each entry.

Classify

Journal entries are transferred, or posted, usually electronically, to individual accounts kept in a ledger. All entries involving cash are brought together in the ledger's cash account; all entries involving sales are recorded in the ledger's sales account.

Summarize

All accounts in the ledger are summarized at the end of the accounting period, and financial statements are prepared from these account summaries.

Financial Statements

Balance Sheet

Income Statement

Statement of Owners' Equity

Statement of Cash Flows

Why you Need Financial Statements

- Applying for loans
 - Start-up loans, operating loans/lines, etc.
 - Typical loan application (“loan app”)
 - 2-3 years of balance sheets, income statements
 - Historical, projected
 - Impress your lender with:
 - Cash flow statement and breakevens
 - Best/worst case scenarios



Why you Financial Statements cont..

- Powerful management tools
 - Compare the business to the industry averages
 - Identify strengths/weaknesses of the business
 - Identify trends within the business
 - Identify strategies to improve
 - Enterprise analysis
- Helps with tax preparation
 - Improved recordkeeping

The Accounting Terminologies

- **Assets** - anything of value owned or leased by a business.
- **Liability** - claim against a firm's assets by a creditor.
- **Owner's equity** - all claims of the proprietor, partners, or stockholders against the assets of a firm, equal to the excess of assets over liabilities.
- **Basic accounting equation** - relationship that states that assets equal liabilities plus owners' equity.
- **Double-entry bookkeeping** - process by which accounting transactions are entered; each individual transaction always has an offsetting transaction.

The Main Financial Statements

- Balance sheet/Statement of financial position
 - Listing of what you own and how you paid for it
 - $\text{Assets} = \text{Liabilities} + \text{Net Worth}$
 - $\text{Value of Assets} = \text{Debt financing} + \text{“Owner financing”}$
 - Tells lender
 - Liquidity and solvency position
 - Outstanding debts, creditors
 - Assets available for collateral
 - Not a useful day-to-day tool for managers

Balance Sheet- Statement of Financial position

- ✓ **Balance sheet(Statement of Financial Position)** - statement of a firm's financial position—what it owns and the claims against its assets—at a particular point in time.
- ✓ Photograph of firm's assets together with its liabilities and owner's equity
- ✓ Follows the accounting equation

Balance Sheet cont...

- Assets = Value of things used in the business
 - Only what you have that day!!
 - Current Assets = life of about 1 year or less
 - Cash, savings, inventory, A/Rec., prepaid, supplies, etc.
 - Non-current Assets = life greater than 1 year
 - Machinery, equipment, real estate, improvements
 - List each at its purchase cost
 - Lenders want market value instead!

Balance Sheet cont...

- ▶ **Liabilities = what you owe as of that day**
 - **Current Liabilities = owed within 1 year**
 - Operating loan, A/Pay., principal due, accrued interest
 - **Non-current liabilities = owed AFTER 1 year**
 - Remaining principal balances
 - List the actual dollar amount owed as of that day

- ▶ **Net Worth = owner's investment as of that day**
 - Original cash invested – withdrawals + additions
 - Retained Earnings ~ net income from previous years

Sample Balance Sheet/ Statement of Financial position

Figure 16.3

Diane's Java Balance Sheet (Fiscal Year, Ending December 31)

1 Current Assets:
Cash and other liquid assets that can or will be converted to cash within one year.

2 Plant, Property, and Equipment (net):
Physical assets expected to last for more than one year; shown net of accumulated depreciation—the cumulative value that plant, property, and equipment have been expensed (depreciated).

3 Value of assets such as patents and trademarks.

4 Current Liabilities:
Claims of creditors that are to be repaid within one year; accruals are expenses, such as wages, that have been incurred but not yet paid.

5 Long-Term Debt:
Debts that come due one year or longer after the date on the balance sheet.

6 Owners' (or shareholders') Equity: Claims of the owners against the assets of the firm; the difference between total assets and total liabilities.

Diane's Java

Balance Sheet

(\$ thousands)	2010	2009
Assets		
1 Current Assets		
Cash	\$ 800	\$ 600
Short-term investments	1,250	940
Accounts receivable	990	775
Inventory	2,200	1,850
Total current assets	5,240	4,165
2 Plant, property, and equipment (net)	3,300	2,890
3 Goodwill and other intangible assets	250	250
Total Assets	8,790	7,305
Liabilities and Shareholders' Equity		
4 Current Liabilities		
Accruals	\$ 350	\$ 450
Accounts payable	980	900
Notes payable	700	500
Total current liabilities	2,030	1,850
5 Long-term debt	1,100	1,000
Total liabilities	3,130	2,850
6 Shareholders' equity	5,660	4,455
Total Liabilities and Equity	8,790	7,305

Example Company
Balance Sheet
31-Dec-14

ASSETS

Current Assets

Cash	\$ 2,100
Petty Cash	100
Temporary Investments	10,000
Accounts Receivable - net	40,500
Inventory	31,000
Supplies	3,800
Prepaid Insurance	<u>1,500</u>
Total Current Assets	<u>89,000</u>

LIABILITIES

Current Liabilities

Notes Payable	\$ 5,000
Accounts Payable	35,900
Wages Payable	8,500
Interest Payable	2,900
Taxes Payable	6,100
Warranty Liability	1,100
Unearned Revenues	<u>1,500</u>
Total Current Liabilities	<u>61,000</u>

Investments

36,000

Long-term Liabilities

Notes Payable	20,000
Bonds Payable	<u>400,000</u>
Liabilities	<u>420,000</u>

Property, Plant & Equipment

Land	5,500
Land Improvements	6,500
Buildings	180,000
Equipment	201,000
Less: Accum Depreciation	<u>(56,000)</u>
Prop, Plant & Equip - net	<u>337,000</u>

Total Liabilities

481,000

Intangible Assets

Goodwill	105,000
Trade Names	<u>200,000</u>
Total Intangible Assets	<u>305,000</u>

STOCKHOLDERS' EQUITY

Common Stock	110,000
Retained Earnings	229,000
Less: Treasury Stock	<u>(50,000)</u>
Total Stockholders' Equity	<u>289,000</u>

Other Assets

3,000

Total Assets

\$770,000

Total Liab. & Stockholders' Equity

\$770,000

The Financial Statements

- Income Statement
 - Shows the economic profit for the period (year)
 - Revenues – COGS – Overhead = EBT
 - Cash vs accrual accounting
 - Lenders & managers use to assess:
 - Profitability, Repayment ability, and Financial efficiency
 - Breakevens, sensitivity analysis
 - Retail operations usually do a weekly income statements



Statement of Income- Extract

- The following example shows some of the common elements of the Income Statement (also known as a Profit and Loss Statement).

**Sample Company
Income Statement**

For the Year ended December 31, 2014

Income		
Gross Sales	346,400	
Less returns and allowances	1,000	
Net Sales		345,400
Cost of Goods		
Merchandise Inventory, January 1	160,000	
Purchases	90,000	
Freight Charges	<u>2,000</u>	
Total Merchandise available for sale	252,000	
Less Inventory, December 31	<u>100,000</u>	
Cost of Goods Sold		<u>152,000</u>
Gross Profit		193,400
Interest Income		<u>500</u>
Total Income		193,900
Expenses		
Salaries	68,250	
Utilities	5,800	
Rent	23,000	
Office Supplies	2,250	
Insurance	3,900	
Advertising	8,650	
Telephone	2,700	
Travel and Entertainment	2,550	
Dues & Subscriptions	1,100	
Interest Paid	2,140	
Repairs & Maintenance	1,250	
Taxes & Licenses	11,700	
Total Expenses		133,290
Net Income		\$60,110

Statement Changes in of Owner's Equity

- ✓ **Statement of Owner's Equity** - is designed to show the components of the change in equity from the end of one fiscal year to the end of the next.
- ✓ Begins with the amount of equity shown on the balance sheet.
- ✓ Net income is added, and cash dividends paid to owners are subtracted.

Sample Statement of Owner's Equity

Figure 16.5

Diane's Java Simplified Statement of Owners' Equity (Fiscal Year Ending December 31)

1 From the prior year's balance sheet.

2 From the current year's income statement.

3 Amount should equal the figure shown on the current year's balance sheet.

Diane's Java	
Simplified Statement of Owners' Equity	
(\$ thousands)	2010
1 Shareholders' equity (beginning of year)	\$4,445
2 Add net income	1,917
Subtract cash dividends	(450)
Add sale of new shares	0
Subtract repurchase of existing shares	(262)
3 Equals shareholders' equity (end of year)	<hr/> 5,660



The Statement of Cash Flows

- The statement of cash flows reports on the company's cash movements during the period(s) classifying them according to three activities:
- Operating,
- Investing and
- Financing

Sample Statement of Cash Flows

Figure 16.6

Diane's Java Statement of Cash Flows (Fiscal Year Ending December 31)

1 Operating Activities: The nuts and bolts of day-to-day activities of a company carrying out its regular business; Increases in accounts receivable and inventory are uses of cash, while increases in accruals and accounts payables are sources of cash; in financially healthy firms, net cash flow from operating activities should be positive.

2 Investing Activities: Transactions to accumulate or use cash in ways that affect operating activities in the future; often a use of cash.

3 Financing Activities: Ways to transfer cash to or from creditors and to or from owners; can be either positive or negative.

4 Net Cash Flow: The sum of cash flow from operating, investing, and financing activities, a reconciliation of cash from the beginning to the end of the accounting period (one year in this example).

Diane's Java	
Statement of Cash Flows	
(\$ thousands)	2010
1 Cash Flow from Operating Activities	
Net income	\$1,917
Depreciation	350
Change in accounts receivable	(215)
Change in inventory	(350)
Change in accruals	(100)
Change in accounts payable	80
Total cash flow from operating activities	1,682
2 Cash Flow from Investing Activities	
Capital expenditures	(760)
Change in short-term investments	(310)
Total cash flow from investing activities	(1,070)
3 Cash Flow from Financing Activities	
Cash dividends	(450)
Sale/repurchase of shares	(262)
Change in notes payable	200
Change in long-term debt	100
Total cash flow from financing activities	(412)
4 Net Cash Flow	200
Cash (beginning of year)	600
Cash (end of year)	800



Cash Flow Statement (Budget)

- Shows all cash coming in/going out and the timing
- Helps the lender and manager:
 - Estimate cash surplus/deficits for each period
 - Shift the timing of cash flows
 - Determine when to schedule loan payments
 - Determine operating loan needs and terms
- The most powerful statement for managers



Cash Flow budget

- Cash “Budget”
- List cash inflows **WHEN** they occur
- List cash outflows **WHEN** they occur
- Bottom half deals with operating loan
 - Thank goodness for computers!
- Helps you do your projected financial statements .

Sample Cash Flow Budget

Figure 16.7

Four-Month Cash Budget for Birchwood Paper Company

Birchwood Paper Company				
Four-Month Cash Budget				
(\$ thousands)	May	June	July	August
Gross sales	\$ 1,200.0	\$ 3,200.0	\$ 5,500.0	\$ 4,500.0
Cash sales	300.0	800.0	1,375.0	1,125.0
One month prior	600.0	600.0	1,600.0	2,750.0
Two months prior	300.0	300.0	300.0	800.0
Total cash inflows	1,200.0	1,700.0	3,275.0	4,675.0
Purchases				
Cash purchases	1,040.0	1,787.5	1,462.5	390.0
One month prior	390.0	1,040.0	1,787.5	1,462.5
Wages and salaries	250.0	250.0	250.0	250.0
Office rent	75.0	75.0	75.0	75.0
Marketing and other expenses	150.0	150.0	150.0	150.0
Taxes		300.0		
Total cash outflows	1,905.0	3,602.5	3,725.0	2,327.5
Net cash flow				
(Inflows – Outflows)	(705.0)	(1,902.5)	(450.0)	2,347.5
Beginning cash balance	250.0	150.0	150.0	150.0
Net cash flow	(705.0)	(1,902.5)	(450.0)	2,347.5
Ending cash balance	(455.0)	(1,752.5)	(300.0)	2,497.5
Target cash balance	150.0	150.0	150.0	150.0
Surplus (deficit)	(605.0)	(1,902.5)	(450.0)	2,347.5
Cumulative surplus (deficit)	(605.0)	(2,507.5)	(2,957.5)	610.0



Ratio Analysis & Benchmarks

- **Ratio analysis** - tool for measuring a firm's liquidity, profitability, and reliance on debt financing, as well as the effectiveness of management's resource utilization.
- Compare ratios to benchmarks
- Look for trends over time
 - That's why lenders want 2-3 years of statements



Ratio Analysis

- ▶ Identify strengths and weaknesses
- ▶ Develop strategies to improve the financial condition
 - Cost control
 - Pricing
 - Marketing
 - Debt structure
 - Labor efficiency, etc.

Financial Ratios cont...

- ▶ Liquidity – ability to meet current obligations
 - Current Ratio $\text{current assets} / \text{current liabilities}$
 - Quick Ratio (current asset – inventory)/cur. liab.
- ▶ Solvency – ability to meet all debts
 - Debt/Asset $\text{total liabilities} / \text{total assets}$
 - Debt/Worth $\text{total liabilities} / \text{net worth}$

Financial Ratios

- Repayment ability

- Times Interest earned = $\text{EBIT} / \text{Interest}$
- Debt Coverage Ratio (DCR) is the ratio of cash available for debt servicing to interest, principal and lease payments. It is used in the measurement of an entity's (person or corporation) ability to produce enough cash to cover its debt (including lease) payments
- $\text{DCR} = \frac{(\text{EBT} + \text{other income} + \text{Depreciation} + \text{Interest Expense} - \text{Taxes \& Family Living})}{\text{Annual P\&I payments}}$

- Profitability

- ROA $\text{EBT} / \text{Total Assets}$
- ROE $\text{EAT} / \text{Net Worth}$

Financial Ratios

- Financial Efficiency
 - Sales/Total Assets
 - COGS/Inventory
 - Operating Exp/Sales
 - Operating Profit Margin EBT/Sales

Liquidity Ratios Calculation

- **Current ratio** compares current assets to current liabilities.

$$\text{Liquidity Ratio} = \frac{\text{Current assets}}{\text{Current liabilities}} = \frac{5,240}{2,030} = 2.58$$

Liquidity Ratios Calculation cont...

- **Acid-test (or quick) ratio** measures the ability of a firm to meet its debt payments on short notice.

$$\text{Acid-test ratio} = \frac{\text{Current assets} - \text{Inventory}}{\text{Current liabilities}} = \frac{(5,240 - 2,200)}{2,030} = 1.50$$

Activity Ratios

- **Inventory turnover ratio** indicates the number of times merchandise moves through a business

$$\text{Inventory Turnover} = \frac{\text{Cost of goods sold}}{\text{Average inventory}} = \frac{10,380}{[(2,200 + 1,850)/2]} = 5.13$$

Activity Ratios cont....

- **Total asset turnover ratio** indicates how much in sales each dollar invested in assets generates

$$\begin{aligned}\text{Total asset turnover} &= \frac{\text{Sales}}{\text{Average total assets}} \\ &= \frac{17,300}{[(8,790 + 7,305)/2]} = 2.15\end{aligned}$$

Profitability Ratios

- ***Profitability ratios*** measure the organization's overall financial performance by evaluating its ability to generate revenues in excess of operating costs and other expenses.

Profitability Ratios cont....

$$\text{Gross profit margin} = \frac{\text{Gross Profit}}{\text{Sales}} = \frac{6,920}{17,300} = 40.0\%$$

$$\text{Net profit margin} = \frac{\text{Net income}}{\text{Sales}} = \frac{1,917}{17,300} = 11.1\%$$

$$\text{Return on equity} = \frac{\text{Net income}}{\text{Average equity}} = \frac{1,917}{[(5,660 + 4,455)/2]} = 37.9\%$$

Leverage Ratios

- **Leverage ratios** measure the extent to which a firm relies on debt financing

$$\text{Debt ratio} = \frac{\text{Total liabilities}}{\text{Total assets}} = \frac{3,130}{8,790} = 35.6\%$$

$$\text{Long-term debt to equity} = \frac{\text{Long-term debt}}{\text{Owners' equity}} = \frac{1,100}{5,660} = 19.64\%$$

Leverage Ratios cont...

- Total liabilities to total assets ratio > 50 percent indicates that a firm is relying more on borrowed money than owners' equity.



WHY IT IS IMPORTANT TO UNDERSTAND FINANCIAL STATEMENTS

1. The statements represents the company's scorecard and present an accurate picture of what happened over the period under review.
2. Should your company wish to obtain outside funding (loans), banks and financial markets require that the audited financial statements be presented for their evaluation as a basis of making credit decisions



WHY IT IS IMPORTANT TO UNDERSTAND FIN STATEMENTS CONT...

3. The statements provide a basis for planning and benchmarking future performance of the company and signing performance contracts with managers.
4. The tax and regulatory authorities usually require you to fill income tax returns and file the statements
5. They provide an accurate picture of performance and can be used as a basis of rewarding managers & workers



WHY IT IS IMPORTANT TO UNDERSTAND FIN STATEMENTS CONT...

6. The financial statements provide a mechanism that managers use to explain to the owners of the company how they have discharged their stewardship responsibility



END OF PRESENTATION

- **THANK YOU**



***BUSINESS FORECASTING,
PROFITABILITY & CASH FLOW
MANAGEMENT***

**A SEED AND ENTERPRISE INSTITUTE
(SEMI)s COURSE PRESENTATION.**

BY

HERICK ONDIGO

SCHOOL OF BUSINESS, UoN

JULY 2015



OVERVIEW OF PRESENTATION

- At the end of the presentation you should be able to understand:
- Business Forecasting
- Why manage the Cash flow ?
- Cash Budgeting- Exercise
- Cash Flow Analysis- Application
- Cash Flow problems & Possible Solutions
- Tips for Financial survival
- Profitability Pitfalls to Avoid or Fix

Business Forecasting-Overview...

- Business Forecasting is rather like creating a map of where you are trying to go and what the financial steps are to get you there (Strategic Financial Forecasting)
- You will often hear that “farming is a lifestyle choice”. However on farms where the farmer needs the land to earn a living, he or she must be a businessman as well as a farmer
- Farming will be very different financially for the next generation compared to how it has been for the past current generation
- Farmers currently operate in a world of high competition, low commodity prices and high input costs

Business Forecasting-Overview...

- There are two main tools that you will use in forecasting
 - ✓ Profitability Budget
 - ✓ Monthly Cash flow forecast
- The Profitability Budget assesses the overall profitability of a proposed enterprise and therefore what level of costs can be incurred
- The Monthly Cash flow forecast attempts to predict the effect on the farms bank or cash balance over the months or year(s)



Why Manage Cash flows?

- In any business the availability of cash when required is critical
- Businesses fail because they run out of available cash, not necessarily because of profitability problems
- As farmer you Must know at all points in time:-
 - ✓ How much cash does the farm have available
 - ✓ What is the level of unpaid bills and when are they due
 - ✓ What cash is the farm owed and when will it be received

Why Manage Cash flows? Cont...

- In farming, cash flow management can be particularly difficult due to the length of time between investment of cash (cash out) and realising a return (cash in)
- Some sectors are easier to predict and manage than others
- Dairy Farming, for example, benefits from a monthly milk cheque that is generally received 30 days after the month in which the milk is produced
- Other Livestock and Arable Farmers however have a much longer period of time between incurring the production costs and seeing sale proceeds come into the bank

Why Manage Cash flow ? – Arable Farm-Case in Point

- April 2015 – Winter Foundation Seeds planted. Cash is therefore spent on Seed, Fertiliser and cultivation costs (Cash Out)
- August 2015 to Early December 2015 – various operations including spraying, fertilizing (Cash Out)
- April 2016 – Harvest costs (Cash Out)
- August 2016 to December 2016 – Seeds sold (Cash In)



Business Forecasting and Cash flow Management

- Profitability is dependent on receipt of the Single Farm Payment (therefore it is critical to establish how much will be received each year)
- There are other expenses to be paid out of the budget before a cash surplus/deficit can be established (Salaries, Seedlings, Drawings, Tax, Capital Investment)
- If you are buying machinery, you may need to do some external contracting/financing to cover these payments
- Over the harvest season the enterprises may be profitable but there will be a significant level of working capital to fund from cash that may not be there

Cash Flow Planning- Forecasting

- Cash transactions often occur in Farming
- It is vital to control & manage the flow of cash to ensure the farm generates a positive net cash flow
- Net cash flow= Cash inflows- cash outflows
- Cash flow analysis and forward planning can be applied to new or ongoing activities




Cash Flow Planning- Forecasting

- A farmer must generate enough cash to meet financial obligations as they fall due without disrupting normal operations
- Cash Flow of a farmer may be affected by:
 - The farm production cycle
 - Cash inflows from product sale (e.g delay sale for higher prices)
 - Delay in payment from customers




Cash Flow Planning- Forecasting

- Can be achieved through preparation of cash budget:
 - Yearly
 - Quarterly
 - Monthly
 - Weekly
 - Daily
- 



Cash Flow Planning- Forecasting

- Cash Inflows include
 - Crop and seed sales
 - Other farm receipts
 - Sale of capital assets
 - Non farm receipts
 - Borrowed money
- 



Cash Flow Planning- Forecasting

- Cash Outflows include:
- Production Expenses
- Capital expenditures
- Loan repayments
- Family living expenditures

Cash Budgeting- Exercise

- Monica and Dan are farmers. Monica earns money from selling cassava while Dan is a fisherman. They have a few chicken and two goats. They have three children attending school. They would like to buy some farm seedlings costing \$6,000 and are wondering whether they can afford it and when to make the purchase.

Cash Budgeting- Exercise

- Dan expects to receive \$ 9,400 from the sale of fish as follows:
- \$400 per month in March, April & October
- \$600 per month in Feb, May, Sept \$ Nov
- \$800 per month in January and December
- \$ 1,200 per month in June and July
- \$1,800 in August

Cash Budgeting- Exercise

- Monica expects to receive \$3,000 from the sale of cassava as follows
- \$300 in January
- \$900 per month in June, July & August
- They expect to sell some small livestock and get :
- \$ 600 per month in January and December

Cash Budgeting- Exercise

- They need Every month \$500 to cover living expenses
- They need school fees as follows:
- \$300 per month in march, June, Sep & Dec
- Dan needs money for boat and net repairs:
- \$200 per month in March, May and July
- \$ 300 in November



Cash Budgeting- Exercise

- Task
- Based on the above information prepare a cash forecast (budget) to indicate whether the farmers can buy the seedlings and if so which month to make the purchase
- Assume the family expects no other sources of cash flows

Suggested Solution

Monica & Dan Farm

Cash forecasting

For the period Jan-Dec 2015

Prepared by

Date

Particulars	January	February	March	April	May	June	July	August	September	October	November	December	Total
Sale of Cassava	\$ 300					\$ 900	\$ 900	\$ 900					\$ 3,000
Sale of Livestock	\$ 600											\$ 600	\$ 1,200
Sale of Fish	\$ 800	\$ 600	\$ 400	\$ 400	\$ 600	\$ 1,200	\$ 1,200	\$ 1,800	\$ 600	\$ 400	\$ 600	\$ 800	\$ 9,400
Total Receipts	\$1,700	\$ 600	\$ 400	\$ 400	\$ 600	\$ 2,100	\$ 2,100	\$ 2,700	\$ 600	\$ 400	\$ 600	\$ 1,400	\$ 13,600
Living Expenses	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 6,000
School Fees			\$ 300			\$ 300			\$ 300			\$ 300	\$ 1,200
Repair of Boat/Net			\$ 200		\$ 200		\$ 200				\$ 300		\$ 900
Total payments	\$ 500	\$ 500	\$ 1,000	\$ 500	\$ 700	\$ 800	\$ 700	\$ 500	\$ 800	\$ 500	\$ 800	\$ 800	\$ 8,100
Surplus (Deficit)	\$1,200	\$ 100	\$ (600)	\$ (100)	\$ (100)	\$ 1,300	\$ 1,400	\$ 2,200	\$ (200)	\$ (100)	\$ (200)	\$ 600	\$ 5,500
Balance b/f	\$ -	\$ 1,200	\$ 1,300	\$ 700	\$ 600	\$ 500	\$ 1,800	\$ 3,200	\$ 5,400	\$ 5,200	\$ 5,100	\$ 4,900	
Balance c/f	\$1,200	\$ 1,300	\$ 700	\$ 600	\$ 500	\$ 1,800	\$ 3,200	\$ 5,400	\$ 5,200	\$ 5,100	\$ 4,900	\$ 5,500	

Cash flow Analysis Applications

- I. To monitor liquidity – ability to meet financial obligations as they fall due
- A farmer should keep two cash records
- Projected cash flow- prepared at beginning of the period
- Actual cash flows – record transactions as they occur- this forms the basis of projection for future period(s)

Cash flow Analysis Applications cont..

- **2. For Farm Planning and Management**
- Compare Actual cash flows with Projections to improve management of the farm
- Actual cash flows from year 1 can be used to forecast/project future cash flows
- Consider any other factors that may change



Cash flow Analysis Applications cont...

- **3. To provide solutions to cash shortfalls**
- Cash flow analysis can be used to identify cash short falls and ways of addressing them; including
 - Borrowing additional funds
 - Mobilizing savings
 - Selling assets



Cash Flow Problems & Possible Solutions

- I. **Low Profitability**- this may be a symptom of cash flow problem:
- **Solution:**
- Analyze the profitability of each farming unit
- Increase profits by either :
- Raising prices or
- Controlling and lowering costs



Cash Flow Problems & Possible Solutions cont...

- **2. Unexpected Cash Problems-** Cash Shortages or Deficits or Surpluses
- **Solution**
- Identify the problem before it occurs
- Prepare cash flow forecasts to give you the time to alter the timing of cash inflows and cash out flows

Cash Flow Problems & Possible Solutions cont...

- **3. Need to Maintain Profitability and Increase Cash flows**
- **Solution**
- Careful evaluation of combination of farm produce
- Combining livestock with Arable farming
- Crop rotation

Cash Flow Problems & Possible Solutions cont...

- 4. High Production Costs
- Solution
- Cost control
 - Using the best seeds and seedling rates
 - Fertilization at the right level
 - Substitution of commercial fertilizers with manure
 - Integrated pest management

Cash Flow Problems & Possible Solutions cont...

- **5. Increase Selling Flexibility**
- **Solution**
- Improve marketing plans
- For non perishable products have some flexibility in timing sales taking into account cost of storage
- The idea is to improve profit per sale



Cash Flow Problems & Possible Solutions cont...

- **6. Need to Reduce Cash Out flows**
- **Solution**
- Lease or rent instead of owning
- Down payments and loan repayments associated with purchase of land, building and machinery may put a heavy burden on the cash flows

Cash Flow Problems & Possible Solutions cont...

- **7. Increase Cash Availability**
- **Solution**
- Consider taking an off- farm job (part or full time) – with proper structures laid for farm
- Re evaluate the expenses associated with farm support activities eg transport, clothing
- Refinancing of loans
- Sale of Assets



Tips to keep your farm business financially on track

- 1. *Prepare a **business plan** setting out exactly what you intend to do for at least the first 3 years.*
- This is the document that determines whether you have a business or not. Be realistic, objective and get others to read it and challenge you on the assumptions you make.

Tips to keep your farm business financially on track cont..

- 2. *Before the start of each harvest/ production year prepare a realistic Profitability Budget.*
- This will allow you to compare the impact on profit of your chosen enterprises and the effect on profit if you change the enterprise mix.
- The Profitability Budget also sets your target level of expenditure for the year. Any spending over and above this will effect your profit.

Tips to keep your farm business financially on track cont...

- *3. Before the start of the harvest/production year prepare a **monthly cash flow statement** for the next 12 months.*
- This is a key document as it will allow you to work out your maximum borrowing requirement and arrange finance in advance.

Tips to keep your farm business financially on track cont...

- *4. Having produced these key documents **monitor** your performance against them on a regular basis.*
- Regular monitoring against budget and cash flow forecast is essential. There is no point creating a map for your journey which you then leave at home!
- Regular monitoring allows you to spot problems early and take corrective action.
- Regular monitoring also allows you to spot opportunities and take full advantage of them

Tips to keep your farm business financially on track cont...

- *5. Keep your accounting records up to date and use the services of a bookkeeper/farm secretary if necessary.*
- These records provide the information that will allow you to monitor both your performance against budget and cash flow.
- Accountants fees are based on the time they spend working on your affairs. The better the records you keep, the less you will pay in professional fees.
Don't be afraid to use the services of a bookkeeper if time does not allow you to keep on top of the records yourself.

Tips to keep your farm business financially on track cont...

- *6. Use a bank manager, accountant and solicitor/lawyer that **understand and specialise** in Farming.*
- Professionals that specialise in the Agricultural Industry are best placed to advise you. They look at a number of farming businesses day in, day out and see what works and what doesn't.

Tips to keep your farm business financially on track cont...

- **7. Communicate with your bank manager and other professional advisors.**
- You will have far more chance of securing additional finance if you stay in regular touch with your bank manager and keep him or her informed of how you are performing against budget throughout the year.
- Farming can be lonely and both your bank manager and accountant can give you valuable advice on a timely basis if you keep them informed.

Tips to keep your farm business financially on track cont...

- 8. Be flexible. *If you identify problems act quickly. Take advice if necessary and put it into action immediately.*
- Business failures are littered with examples of good businesses that don't survive due to people "putting their head in the sand".

Tips to keep your farm business financially on track cont...

- *9. If you are going to use computer software to do your accounts ensure that you get the right Hard Ware, Software, and Training before you start.*
- A number of businesses have started by purchasing some cheap (off the shelf) accounting software and tried to teach themselves. Unfortunately this often leads to numerous problems including VAT return errors.
- In addition, computerised accounting systems which have been used incorrectly can take longer to put right than manual records.



Tips to keep your farm business financially on track cont...

- *10. Remain positive and never forget that you are working in the farming industry because it is your passion.*
- There are times in all businesses when the going is tough and you will question your reasons for continuing. The most successful businesses however continue to be those that are set up by individuals who have a true passion for what they do.

Ten Profitability Pitfalls to Avoid or Fix # 49

- *Cost of Goods Sold (COGS) should not exceed the proceeds from sale (Sales)*
- Analyze the drivers of COGS which include
 - Poor crop management and harvest practices
 - Poor out grower selection and oversight
 - Poor yield due to weather
 - High obsolescence due to poor storage
 - Loss of out growers due to failure to honor agreements
 - Failure to record and analyze production costs

Ten Profitability Pitfalls to Avoid or Fix # 49 cont...

- **2. Excessive distribution costs**
- Geographical location of customers widespread
- Poor infrastructure
- High fuel cost
- High maintenance costs of delivery vans
- Not factoring distribution cost
- Delivery not justified by the margins

Ten Profitability Pitfalls to Avoid or Fix # 49 cont...

- **3. Poor Receivables/Debtors management**
- Poor credit standards
- Granting credit to customers who are not credit worthy
- Poor collection efforts
- Poor monitoring of Debtors
- Delayed invoicing/reminders
- Long credit periods

Ten Profitability Pitfalls to Avoid or Fix # 49 cont...

- **4. Poor quality products/ seeds**
- Substandard seeds that may not attract good prices
- Lost reputation from customers
- Availability of substitutes of superior seeds at reasonable prices

Ten Profitability Pitfalls to Avoid or Fix # 49 cont...

- 5. Production of wrong products/ seeds without regard to the tastes and preference of customers
- Holding excessive levels of inventory that cannot be sold
- High storage costs
- Obsolescence and perishability of seeds

Ten Profitability Pitfalls to Avoid or Fix # 49 cont...

- **6. Too much price concessions**
- Trying to undercut competitors
- Too much drive to sell
- Lack of proper costing systems
- Selling at a price below the variable costs of production
- Costs of production in excess of sales proceeds leading to losses

Ten Profitability Pitfalls to Avoid or Fix # 49 cont...

- **7. Slow or poor planning and processing of seedlings leading to :**
- Stock outs
- Missed sales
- Last minute distributions which maybe too costly
- No safety or buffer stock

Ten Profitability Pitfalls to Avoid or Fix # 49 cont...

8. Poor pricing Decision

- Price of seeds depends on a number of variables including:
- Value of product/seed to a customer- it is possible to practice price discrimination to different customers
- Cost structure of the company- the cost incurred up to the point of sale
- Profitability goals of the farmer
- Availability of competitors or substitutes

Ten Profitability Pitfalls to Avoid or Fix # 49 cont...

- **9. Financial illiteracy of the management team:**
- A farmer is essentially a businessperson
- He/she must understand the meaning of the financial statement numbers
- Have a firm grasp on the financial position, financial performance , cash flows and business forecasting

Ten Profitability Pitfalls to Avoid or Fix # 49 cont...

- **10. Poor staffing decisions**
- Employing people based on criteria other than competence
- Failing to match people with jobs
- Too much costs paid on salaries and wages
- Poor human resource policies- not sure when to hire and fire



END OF PRESENTATION

- **THANK YOU**