THE EFFECTS OF BUDGETING PROCESS ON FINANCIAL PERFORMANCE OF COMMERCIAL AND MANUFACTURING PARASTATALS IN KENYA

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DECLARATION

I declare that this is my original work and has not been presented for a degree in any other university.

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Thanks to the Almighty God for with Him, everything is possible. To all, God bless the work of your hands.
DEDICATION

This research paper is dedicated to my parents, sisters and brother, my son Adrian and friends for their encouragement, advice and support that they have accorded me during my studies.

I specifically thank my parents; Mr and Mrs Wilson Maritim for their financial and emotional support by investing in my education.
ABSTRACT

The budgeting process in any organization forms an integral part of any management process. The ways of generating and utilizing the revenue in the firm will give a roadmap of achieving the organizational objectives. The budgeting process of an organization affects the level of performance of a firm and it is important therefore that that organization adopt efficient budgeting processes that will be able to provide more accurate results of the firm's performance in the targeted period. The objective of the study was to determine the effects of budgeting on the financial performance of manufacturing and commercial Parastatals in Kenya. Towards the realization of the same objective, a descriptive research design was adopted and data was collected by use a questionnaire. A regression was also carried out to establish the relationship between the ROA and the budgeting independent variables.

The researches of the findings were that the budgeting practices that are common among the firms are budget planning, budget participation, budget participation and budgetary sophistication. However, employee participation in the budgeting process resulted in greater success in actualization of the plan set out in a particular period followed by budget planning. The results therefore reinforced the need for a participatory budgeting process whereby all cadres of staff through their sectional heads are involved and their views are incorporated in the budget process. Establishment of a feedback mechanism was also found to be important in actualization of the budget.
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CHAPTER ONE
INTRODUCTION

1.1 Background of Study

1.1.1 Introduction

The primary goal of the government has been the provision of the essential goods and services to the citizens. This is achieved by executing projects towards enhancing social and economic well-being of the citizens. These goods and services are normally provided through ministries and government agencies known as parastatals or state corporations. Though with a clear mission as its central thrust, its reason for existence, it may neglect to use accounting information to facilitate organizational control. It is in this view that improved parastatals financial performance is increasingly crucial to the Kenyan economy because of its macro-economic effects and because of the key sectors controlled by these parastatals. There is a consensus that the sector has performed poorly in Kenya, especially in terms of products and service delivery and efficiency. Thus there is sufficient richness of experience in the parastatals sector in Kenya that it should be possible, through a careful comparative study, to demonstrate the effectiveness or lack thereof, of various types of controls which have been proposed Barbara (1984). A budget is and has been one of the controls used as is an important instrument of national resources mobilization, and fiscal and economic management.

1.1.2 Budgeting Systems

A budget is an economic instrument for facilitating and realizing the vision of the government in a given fiscal year. It is a framework which provides an appropriate
According to Conmick et al. (1988) for many decades, empirical research has documented extensive use of budgeting systems. These studies have largely highlighted the significant emphasis, which diverse types of organizations in various countries, put on budgeting systems, as key elements of management control. As stated by Little et al. (2002) budgeting is one of the fundamental decision-making process in an organization, actually a number of studies attempt to link the extent of the budgeting process with its potential effect on firm performance. The most intensive discussion in previous budgeting studies has been on budgetary participation and its impact on firm performance, which only focuses on private organizations while for government institutions are overlooked by most of researchers. With the recent changes to budget preparation and the introduction of a multi-year budgetary system it offers considerable potential to link policy, planning and budgeting in a more coherent way than has been the case in the past. In order to fill in the gaps in previous research, the author poses a number of questions and intends to gain a deeper understanding about how budgeting affects financial performance of the parastatals in Kenya.

1.1.3 Financial Performance of Parastatals

The financial performance of a corporation is of vital interest to many different groups and individuals. Lenders are concerned with the corporation's ability to repay loans as well as whether it is abiding by loan contracts. Purchasing agents for other companies are concerned with its viability as a supplier of goods or services for its products. Potential
investors are interested in determining the financial strength of a company as an element in assessing the company's value. In addition public sector bodies do not operate in a vacuum and their performance has a significant effect on the national economy as they are funded by some form of taxation. They also have an effect on the Public Sector Borrowing Requirement (PSBR) by borrowing money to fund expenditure. By aggregating budgets throughout the public sector, the government can then monitor its activities against its plans or targets and take appropriate action to ensure that these are met Bird and Kirira (2012). According to Musembi (2012) the performance of the public sector has become a common phenomenon the world over especially in developing countries and the delivery of efficient and effective services to its citizens continues to be a major concern to governments. One of the key priorities of the Kenyan Government is to implement and institutionalize public sector reforms that lead to an efficient, effective and ethical delivery of products and services to the people of Kenya.

1.1.4 Relationship between the Budgeting and Performance

To enable effective decision making, budgeting and financial management systems in an organisation should be evolved and integrated to provide timely, accurate and comprehensive information for all tiers of management. To be effective, performance measurement must be thoroughly integrated into a government's budgetary process. The introduction of performance budgeting has been linked to broader efforts to improve expenditure control as well as public sector efficiency and performance. Thus, performance budgeting can be combined with increased flexibility for managers in return for stronger accountability for the results, so as to enable them to decide how to
best deliver public services. Performance budgeting initiatives tend to go hand in hand with performance management. These initiatives seek to shift the focus and emphasis of management and budgeting away from inputs and processes towards measurable results. The initiatives can be combined with reductions in input controls and increased flexibility for managers – in return for stronger accountability for the results – so as to enable them to decide how to best deliver public services. Infact some countries have followed a formal approach, in which the MOF requires spending ministries and state corporations to present performance plans and/or performance results along with their spending proposals, while other countries have no formal requirements. Performance Information can be used by the MOF for planning purposes and/or accountability purposes.

It is in this context that budgeting can either have a positive or negative effect on financial performance of state corporations but still this depends on how the operations are managed to achieve the set targets. It influences on the financial objectives, the allocation of funds as well as investment ventures that organization undertakes has to be sought. Budgeting can be prone to challenges which may hinder effective achievement of budgetary objectives. The effect on financial performance of commercial and manufacturing parastatals hence the efficient service delivery cannot be overemphasized and that is the motivation behind the objective of this research.
1.1.5 Parastatals in Kenya

A parastatal is a legal entity created by a government to undertake commercial activities on its behalf. Alternatively it can be referred to as a public sector or state corporation which is that part of the economy that is controlled by the government for the purpose of providing basic government services. These basic services that the government need to provide are so enormous due to increase number of people they service. Kenya has two hundred and six (206) parastatals categorized according to their mandate i.e. regulatory, service, commercial and manufacturing etc. but for the purpose of this study will only focus on the commercial and manufacturing corporations (Appendix II). An Act of Parliament, State Corporations Act Cap 446, exists to make provision for the establishment of state corporations; for control and regulation of state corporations; and for connected purposes. Under section 3 of the Act the President may, by order, establish a state corporation as a body corporate to perform the functions specified in the order. He then assigns ministerial responsibility for any state corporation and matters relating thereto to the Deputy-President and the several cabinet secretaries. Under the same Act Section 5 every state corporation shall have all the powers necessary or expedient for the performance of its functions, State Corporations Act (2010). In addition there is a State Corporations Advisory Committee (SCAC) that has been given the mandate to advice the government on all matters pertaining to the general administration of State Corporations as spelt out in section 27 of the Act but also in several other sections of the act bestowing altogether a number of statutory functions (www.scac.go.ke).
The Controller of Budget Ms. Agnes Odhiambo recently said “The Government should put in place measures to improve the performance of corporations to enable them refund the funds paid on their behalf. This was due to the fact that available figures indicate that in 2012, the City council of Nairobi was owed a total of Shs.109 Billion by various private and public organizations and individuals” Akoth(2013 March 18). From these developments financial performance of parastatals become a point of interest to be studied. This persistent deteriorating status of state corporations has given the researcher the keen interest to investigate on the effect of budgeting and how it has influenced the financial performance of these commercial and manufacturing corporations.

1.2 Research Problem

Most often research on budgeting has greatly concentrated on profit- oriented organizations and the effect of budget participation as it effects subordinates’ managerial performance positively. According to psychological theories (Shields and Shields 1998) budgeting process and participation causes improved performance and consequences of performance in the role can be clarified by participating in the planning and evaluation stage of budgeting but from a cognitive point of view through budget participation subordinates gain information from superiors that helps them clarify their organizational roles and expected performance which in turn enhances their performance.

According to the literature on the subject, this effect cannot be ruled out, but there is a possibility whether the way of linkage is negative or positive. According to Kenis (1979), while some studies have supported the argument that budgeting positively and significantly associated with performance other studies have found either only a weak
positive association between BP and performance Milani (1975) or a negative association between two variables Bryan and Locke (1967). It is time to determine effect of budgeting on the financial performance of commercial state corporations or parastatals.

Locally, a number of studies have been done on the performance of parastatals, Kihara (2013) sought to find out the factors affecting the implementation of strategic performance measurement system of parastatals in Kenya, he focused on only one state corporation and one aspect of strategic performance while Gachithi (2010) focused on the factors that influence budget implementation in public institutions in Kenya though she focused on only one state corporation the report gave an overview of the institution and the budget process it has adopted but only challenges of budget implementation in public institutions was considered. Another study by Njagi and Malel (2012) aimed to examine the relationship between time management strategies and job performance in organizations with a particular focus on parastatals. The general objective was to find out the effects of time management strategies on the performance of selected parastatals in Kenya. Owing to this limited focus by the above researchers, this study sought to establish the impact of budgeting on the entire performance of parastatals in Kenya.

1.3 Objective of the Study

The objective of the study is to determine the effects of budgeting on the financial performance of parastatals in Kenya.
1.4 Value of the Study

There is no more opportune time than now for this study given that government resources are dwindling and the performance of state corporations are wanting. The parastatals share of the national budget has been on the decline for some time now and this complied with the ever-increasing government responsibilities of catering for its citizens. Many stakeholders will benefit from this study. The government will be guided on the allocation of resources and evaluating its relevance to the performance of the parastatals through agencies like SCAC, Auditor General, Ministries and State Inspectorate.

Commercial and other parastatals will get more understanding on the effect of budgeting on their financial performance and can even be a basis for conducting a peer review among and within themselves as the effect will likely differ in the parastatals. It will also help in increasing efforts to improve expenditure control as well as public sector efficiency and performance combined with increased flexibility for managers in return for stronger accountability for the results, so as to enable them to decide how to best deliver public services.

Providing information about public sector financial performance will satisfy the general public and other stakeholders’ need to know and to show that these parastatals are providing good value for money. It will also enlighten them and hence will thus appreciate the existence of parastatals and provide a benchmark for evaluating their performance in the efficient service delivery. To the researcher it will shed more light on the budgeting concept and how it influences financial performance of organisations thus establish research gaps basis for further research.
2.1 Introduction

The literature reviewed in the study will help review theories and past empirical studies, the salient issues about the budgeting process and performance measurements and the performance in the firms.

2.2 Review of Theories

2.2.1 Theory of Control

Adequate control is very essential to every organization be it individual or government owned all over the world. This is because if there is no adequate control of resources in the organization, it will be practically impossible to appropriate budgets and accounting practices becomes a waste. The theory of control specifies the obligations of government industries in providing social and basic amenities to the citizens. It indicates that government owned industries is a basic principle of control on those scarce resources they are meant to manage. As Shields and Young (2009) contend that government industries ought to provide both resources and employment to the citizens for meeting the laid down objectives. This implies that the government, board members and staff have joint responsibility to ensure proper accounting practices and timely budgetary implementation and appropriations by building effective management controls and directions.
As per this theory, parastatals are expected to live to its responsibility of establishing standards, adequate controlling mechanism and acceptable accounting practices. According to Conard (2003), government enterprises need not to have unethical persons acting outside controls as ineffective control system in every organization can negatively affect organizational profitability and sustainability as well as company's resources and performance. This means the government; the board members and staff of these parastatals have a joint responsibility to ensure proper and effective budgeting and its implementation by building effective management controls and directions which will eventually ensure performance is achieved through efficient service delivery.

2.2.2 Contingency Theory

Contingency approach to management accounting is based on the premise that there is no universally appropriate accounting system, which applies equally to all organisations in all circumstances Otley (1980). Since a performance measurement system is considered part of the management accounting system or at least depends on it in great part, the contingency approach to performance measurement can be formulated in the same way. Contingency theory therefore attempts to identify specific aspects of a performance measurement system that are associated with certain defined circumstances and to demonstrate appropriate matching Rejc (2003).

It is important, that in our research, we identify specific features of an organisation's context that impact on articuler features of performance measurement design. Three main classes of contingent factor have been identified as influencing the accounting system
design: the environment, organizational structure and technology Otley (1990). Relevant features of the organization's environment affecting its accounting system design that have been suggested include its degree of predictability, the level of competition faced in the marketplace, the number of different product/market encountered, and the degree of hostility exhibited. Structural features suggested include size, interdependence, decentralisation and resource availability. Technological factors include the nature of the production process, its degree of routines, how well means-end relationships are understood and the level of task variety. Of these, environmental factors have most often been researched. A consideration of corporate strategy has, quite surprisingly, not been prominent in studies or control design despite some arguments that differences in corporate strategies should logically lead to differences in planning and control systems' design. The key question here, then, is which classes of contingent factor can be identified as influencing performance measurement in Kenyan parastatals.

2.2.3 Theory of Motivation

Motivation to perform is guided by the use of budget as it sets the standard and a good measure of achievement in comparison with the expected estimates Bryan (1967). Motivation is the force that initiates, guides and maintains goal-oriented behaviors. If managers and subordinates are to be motivated to achieve higher levels of performance, it is not enough that a budget or financial target represents a specific quantitative goal but essential that these targets are accepted. It is impossible to specify exactly the optimal degree of difficulty for targets since task uncertainty, personality factors, cultural and organizational issues will all affect this.
In addition if budgets are to be set at a level which motivates individuals to achieve maximum performance adverse budget variances are to be expected. In this situation it is therefore essential that adverse budget variances are not used by management as a punitive device since this is likely to encourage budgetees to attempt to obtain looser budgets by either underperforming or deliberately negotiating easily attainable budgets. As Hofstede (1967) concluded budgets have no motivational effect unless they are accepted by the managers involved. Demanding budgets are seen as more relevant than less difficult targets but negative attitudes result if they are seen to be too difficult. Acceptance of budgets is facilitated with good upward communication skills and regular meetings, managers reactions to budget targets are affected by their own personality and more general cultural and organizational norms. According to Otley (2000) after developing a model which demonstrates the theoretical relationship between budget difficulty, aspiration and performance he suggested that the optimum point at which a budget would cease to motivate may be where individuals perceive that there is significantly less than a 50% chance of it being achieved. Inevitably there is a trade-off between adopting tight budgets to maximize performance even though this may ultimately not be achieved and using achievable budgets which provide managers with a sense of achievement and self-esteem but do not maximize performance and achievement. Highly achievable budgets are therefore to be preferred from the motivational perspective but are likely to result in aspirational levels and performance not being maximized. It is essential in planning any performance related bonus scheme that managers have an incentive not only to achieve any budget target but also to exceed it.
2.3 Review of Empirical Studies

According to Mia (1989) after a careful examination on the interactive effect of participation and job difficulty on managerial performance and work motivation in a budgetary context using middle-level managers from six companies working in various functional areas as subjects, the study found out that managerial performance was high where perceived participation was commensurate with perceived level of job difficulty. On the other hand, performance was low where participation was not commensurate with the perceived level of job difficulty. No significant interactions were obtained with respect to work motivation.

A study by Yang (2010) intended to gain a deeper understanding about how budgeting affects the performance of SMEs in China. He reviewed the budgeting process in business organizations and performance measurement in SMEs and found out that more formal budgeting planning promotes higher growth of sales revenues in SMEs, clear and difficult budget goals improve budgetary performance of organisations, a higher level of budgetary sophistication results in a lower profit growth of SMEs, more formal budgetary control leads to a higher growth of profit in the organisations and a greater budgetary participation leads to better managerial performance. Medium-sized firms achieve higher profit growth than small firms and state-owned enterprises achieve better non-financial performance than small firms.

According to a study by Birech (2011) the use of PC has been acclaimed as an effective and promising means of improving the performance of public enterprises as well as
government departments but despite the availability of extensive existing literature on the PC there is no information on the impact of PC on performance of state corporations in the energy sector in Kenya. He collected views, opinions, perceptions, feelings and attitudes on the effects of PC on performance of state corporations in the energy sector in Kenya. He concluded that doing the job efficiently was the central theme of the public sector reform and that PC promoted commitment in revenue collection at the energy corporation to a very great extent though there were challenges in the implementation of the PC program to a moderate extent. The study thus recommended the government to implement the PC at the energy sector, to structure the PC in a way it will enhance consistency in revenue collection at the energy corporation and to motivate the staff and encourage them come-up with a new idea or product or service to enhance revenue collection at the energy corporation.

Chai (2011) conducted a study aimed at establishing the capital budgeting techniques and how those techniques impact to the financial performance of courier companies in Kenya. Several capital budgeting techniques were evaluated for their relationship with the firm's financial performance i.e. Return on assets and findings showed that Profitability index was highly related to the measure compared to other techniques. Methods used to assess risk analysis in capital budgeting were also evaluated e.g. scenario analysis, sensitivity, decision tree and simulation. He found out that scenario analysis was used more often by managers in assessing the risk analysis and they preferred using cost of equity in determining minimum rate of return for evaluating appropriate projects that the cost of debts or weighted average cost of capital. He then concluded that there was a significant
relationship between the capital budgeting techniques and the financial performance of courier companies.

Another study by Adongo (2012) to determine the salient features of budgetary controls in state corporations, to establish the human factors within budgetary controls, establish the process of budgetary control in public organizations and determine the challenges affecting budgetary control, observed that there are factors affecting financial performance which thus reveal that there are gaps that remain on the influence of budgetary control on financial performance of public institutions. He found out that a positive relationship existed between budgetary control and financial performance of state corporations and that existing budgetary features reflect ability to predict financial milestones of organizations. In addition, human factors within budgetary controls had to do with managerial commitment, employees' motivation, employee training and competence as well as the attitude between managers and other employees towards the budget process. He thus recommended sensitization among management and employees of state corporation on the importance of budgetary controls in enhancing financial performance, avoidance of political interference in the budgetary process and use of budgets not only as tools for management and indicators of management, but also as practical tools within which organizations should use to enhance their financial goals.

Faleti and Myrick (2012) carried out a study to determine the effects of the formal budgeting process, budgetary participation, sector size, and ownership on the employment performance of Nigerian ministries, departments, agencies and parastatals.
The study drew on observations from the area of financial planning and control and its influence on employment performance, and was conducted to fill the gap in previous literature about how budgeting practice affects employment performance. The theoretical exploration was to provide fresh insight into the possible correlation between budgeting practice and employment performance. A combination of financial and non-financial measurements was suggested to reflect the effectiveness of budgeting practice on employment performance. The findings provided more evidence regarding the impact of the budgeting process on employment performance, and suggestions for increasing employment performance level in Nigeria was provided, thus providing possible solutions to similar challenges faced by other developing countries.

Finally, research by Ugwuanyi and Ebe (2012) aimed at identifying the major causes of poor accounting and budgetary practices in government owned industries, to determine the effects of these problems on implementation of budgets in government owned industries and analyse the impact of these numerous problems to the growth and development of government industries in Enugu State. It found out that there exist poor accounting practices in government owned industries in Enugu State and also appropriate budgetary implementation are hardly kept by these industries. In addition, employment into these industries was defective hence poor accounting practices and impact of budgetary implementation is hardly met. The implication of the findings were that due to the fact that required personnel often do not occupy the right position in government industries in Enugu State it creates loopholes especially in area of accounting and its budgets this affecting the performance of the entire industry. Among
other recommendations from the study the government was advised to introduce policy where wrong appointees would be re-visited or cancelled and if possible to ensure that correct personnel were employed for effective performance. Additionally, national growth should be preferred by introducing measures that would motivate and increase individual representative willingness and performance through incentives and rewarding system.

2.4 Budgeting

2.4.1 Budgeting Goals in Business Planning

Business planning, as described by several scholars in a similar way in the past, is, in general, the conscious determination of courses of action to achieve preconceived objectives. It is based on what is known about the present business environment of that future business. Rather than being a fixed document, a business plan must be flexible enough to change to suit the current environment. It must be constantly reassessed to adapt to changing market conditions such as new competition, price changes, personnel availability, and so on (McLaughlin 1992). In contrast to business planning, budgeting underlines predicting and quantifying the future in financial terms and predicting the future needs for finance. Therefore, budgeting is situated between the disciplines of finance and planning. Budgeting data are the most tangible decision causes considered by decision makers (Wooldridge et. al, 2001).

Traditionally, budgeting is considered to be one of the most important management tools to steer the organization, evaluate its performance and motivate its people. As
Flamholtz (1983) states that a budget provides a mechanism for effective planning and control in organizations. Clarke and Toal (1999) is of the opinion that budgets are still essential and can, for example, be incorporated as part of the financial component of the balanced scorecard. To achieve these objectives the budget goals should be clear and not difficult to implement (Yuen 2004) has long stressed the beneficial effect of budget goals on promoting performance in an organization. Normally goal clarity and goal difficulty are analyzed to show their potential link with performance.

Goal clarity is the extent to which budget goals are stated specifically, clearly and are understood by those who are responsible for meeting them (Yuen 2004). Researchers believe that managers working with unclear goals are faced with high uncertainty in relations to goal achievement while clear goals reduce uncertainties in budgeting process which in turn will improve performance of enterprises. Several studies have supported the positive effects of task goal clarity on performance, for example Locke and Schweiger (1979) indicates that goal clarity can improve budgetary performance whereas lack of clarity leads to confusion, tension and dissatisfaction among employees.

Budget goals can be difficult and thus criticism of the budget process has increased considerably in the past decade. The critics of budgets claim that budgets are bad for business, are no longer adequate and are "fundamentally flawed" as planning and control mechanism in today's complex and highly uncertain business environment McNally (2002). Budget goals can vary from very loose and easily attainable goals to
very tight and unattainable goals. This means easily attainable goals will require less effort, knowledge and skills to attain unlike difficult goals. Therefore, the level of budget goal difficulty may impact performance.

2.4.2 Budgeting Process

If governments want to use performance information in budget setting, they need to find a way to integrate performance into the budget decision process, not just the budget paperwork. Previous studies indicate that the extent of the budgeting process ranging from the narrowest, no budget use, to the broadest detailed comparison between actual performance and budgeted performance, with frequently corrective action impacts the performance of any organisation. The more a formal budgeting process is used, the higher the rating of performance in organizations. However, the dimension of the formal budgeting process is only restricted in terms of budgeting planning and budgetary control. It is necessary to give a much broader definition of the formal budgeting process, because other aspects or dimensions related to the budgeting process are also, as argued before, strongly linked with performance. In theory, the activities of predicting and qualifying future requirements for finance so-called budgeting, triggers a series of activities and achieves multiple objectives in an organization such as planning, coordinating, communication control, and evaluation. However, in reality, budgeting process presents more diverse patterns. Some organizations have no single budget plan at all. The budgeting process in some organizations covers planning and control. While for other organizations, budgeting process has been implemented to a very advanced
Yang (2010). Therefore, in this study, the existing model of formal budgeting process in parastatals will add more dimensions that are expected to affect performance of parastatals.

The impact of the budgetary process on a group of persons may be quite different from the impact on the individual within the group. When BP is discussed, traditionally it is only related to performance. Thus, many studies in the past intended to find the link between budgetary participation and managerial performance. It seems that no single research puts budgetary participation into the budgeting process and emphasizes its role under this condition. Participation by individuals will lead to greater group interaction, which will be a good thing if the individuals value their membership of the group and see the goals of the group as being collective targets that they all regard as desirable. Where budgets are used to measure performance, the managers who set these budgets may be tempted to build in some element of spare resources that allow a lapse from actual high levels of performance without deviating from budget targets. Indeed, the basic significance of the subject stems from increasing importance of determining dimensions of BP’s effects on subordinates’ performance in the present competitive conditions for firms Eker (2006).

Budgetary participation is expected to be a crucial channel to improve the information exchange and sharing among all levels of management but most researches only applied this model to large and private firms and their results are
The role of BP in government owned firms and its effectiveness on the performance are unclear so far. According to Joshi, et al. (2003), examined budgeting planning, control, and performance evaluation practices in a developing country found out that most of the firms prepare long-range plans and operating budgets, and use budget variances to measure a manager’s performance, for timely recognition of problems, and to improve the next period’s budget. Merchant (1981) points out that the budgeting process is adopted differently in forms which differ in size and/or diversity of organizational but researchers have not paid considerable attention to the possible relationship between budgeting process and performance in parastatals.

Traditionally, budgeting is viewed as a technical process to reflect and promote rationally in decision making or as a technical device for coping with an objective world and to rationally foster efficiency, order and stability Covaleski et.al(1985). Merchant (1981) however states that the adoption of more sophisticated budgeting including greater use of computer, technical staff and financial modeling enhances the accuracy of the budget plan and the degree of information accuracy and the connectability of budgetary plan and in turn results in higher performance in firms. However, more empirical research is required to prove the positive relationship between budgeting sophistication and performance.
2.5 Financial Performance

2.5.1 Overview of Performance

According to Pollitt and Bouckaert (2004) the performance of the public sector can be investigated on different levels of aggregation. An assessment of performance against planned actions and targets will highlight issues which need to be addressed in future plans and budgets. For this to be achievable initial plans and targets must be measurable and achievable, must be made on a timely basis and must provide a clear indication of further actions required to address poor performance. An effective system of performance review should also prompt regular reviews and assess performance at least quarterly, determine reasons for failure, ensure performance review information is available in time to feed into next year's budget and planning process. However as Bird and Kirira (2009) puts it, much remains to be done at sector level to secure this system, as there appears to be a continuing separation between the planning of activities and budget planning in various strategy and planning documents. Performance based budgeting is at an early stage and so far change has not been that dramatic. This is especially the case in ministries that complain of a lack of technical skills to handle performance budgets and therefore there is a tendency to continue with the use of incremental budgeting. Instability also continues over the financial year due to a lack of finance, and the challenges of managing risks associated with multi-year budgeting are yet to be addressed.

External analysts and managers within the corporation are normally concerned with analyzing its financial performance. These internal analysts compare the actual
performance of the company and its divisions and lines of business with plans, budgets, or objectives; they also compare the company's performance with that of current and potential competition. The primary sources of information these analysts use to evaluate a firm's performance are its financial statements, the historical record of its past performance. Performance assessment via financial statement analysis is based on past data and conditions from which it may be difficult to extrapolate future expectations. Any decision to be made is a result of such performance assessment can affect only the future – the past is gone, or sunk. While past performance is interesting, many managers and analysts are more interested in what will happen in the future. The past performance of a company, as shown in its financial statements, may be used to help predict future performance Harrington, Wilson, (1989). When analyzing financial statements, one must keep in mind the purpose of the analysis. Since different analysts are interested in different aspects of a corporation's performance, no single analytical technique or type of analysis is appropriate for all situations. However, there are several general things the analyst should bear in mind in reviewing data on financial statements.

2.5.2 Financial Performance Measurement

One of the most fundamental facts about businesses is that the operating performance of the firm shapes its financial structure. It is also true that the financial situation of the firm can also determine its operating performance. The financial statements are therefore important diagnostic tools for the informed manager.
A number of studies linking the use of budget and its effects to better decision making or improved financial performance of companies have been done. However, broadcast surveys of usage have difficulties in this respect, due to the wide variations in definition of 'what constitutes performance measurement' Adams (2002). As the focus of budget systems has changed from input to output and outcome, measurement of performance has become a critical issue. Performance tends to be conceptualized to focus on the measurability of efficiency and effectiveness Miller et al. (2001) and Bouckaert and Halligan (2008). Performance, in practice, needs to be defined to be measurable and utilizable for managing government operations in the public sector. In this sense, it is not easy or reasonable to define performance as a unique concept. Behn (2003) noted that no single performance measurement is appropriate for overall management. Bovaird (1996) makes a significant suggestion that performance is not a unitary concept, within an unambiguous meaning rather; it must be viewed as a set of information about achievements of varying significance to different stakeholders. Both financial performance and non-financial performance are important as financial performance is based on financial indicators which reflect the fulfillment of the economic goals of the firm and non-financial performance to reflect the overall performance of an organization Otley (2000).

To measure financial performance in a nonprofit organization, it is essential to start with a consideration of the organization's mission Drucker (1990) and Turk et al, (1995). Given that the mission of a nonprofit organization is the reason its existence, it is appropriate to focus on financial resources in their relationship to mission. Turk et al (1995) also considered velocity, the measure of speed involved in completing a service, as a measure of efficiency and effectiveness. Another measure of quality is in
relation to the training of the leaders. The retention of membership is a further important goal in measuring the efficient and effective use of resources, but it may be difficult to measure this in many NPOs. Lau and Sholihin (2005) recognizes the inherent advantages of financial measures as they are objective and certain to provide a summary view of the success of the organization’s performance and operating tactics. However, it is insufficient to merely analyze firm’s performance by financial performance, especially under today’s changing business environment.

2.5.3 Profitability Measure of Financial Performance

The primary variables used in research and practice to represent the financial performance construct are the accounting measures. These measures rely upon financial information reported in income statements, balance sheets, and statements of cash flows. Accounting measures can be further subcategorized into profitability measures, growth measures, leverage, liquidity, and cash flow measures, and efficiency measures. Normally for commercial and manufacturing entities profitability measures include values and ratios that incorporate net income or a component of net income such as operating income or earnings before taxes are used. It is through the generation of a profit that an organization is able to provide a return to providers of equity capital, once the profits have been converted into liquid assets. In the absence of profits or the likely prospect for profits, equity capital providers will withdraw their resources from an organization and redeploy them to alternative investments where a positive return can be realized. Of the profitability measures, return on assets is the most frequently utilized and thus appreciated for this study.
Return on assets measures the organization's ability to utilize its assets to create profits. ROA is defined by the formula:

\[ \text{Return on Assets} = \frac{\text{Net income}}{\text{Average total assets}} \]

The primary reason cited by authors for selecting this measure is that it is widely used in prior studies. Hitt and Hoskisson (1997) chose ROA rather than ROE, because ROE is more sensitive to capital structure. ROA varies significantly across industries as a result of differing capital intensity, financial structures, and accounting policies. Generally, most entrepreneurship and strategic management researchers are interested in the effects of managerial decisions on operating income. Companies with significant non-operating assets may have significant non-operating income. Although it is a managerial decision to maintain significant investments in non-operating assets, generally researchers are interested in phenomenon that impact operations. Accordingly, it may be appropriate to exclude non-operating income from profitability measures.

Many researchers have argued that the performance of an organization and the success of its programs are influenced by both internal and external elements these include the capability of its personnel, its organizational type, its administration, organizational strategy, its organizational culture, and the external environment in which it functions. As Boyne and Walker (2005) suggested, a growing number of studies show that management does matter many issues remain to be addressed about how public management variables are related to organizational performance. Also, in the public sector, many studies have suggested that management is one of the critical factors which affect the outputs and
outcomes of programs. Furthermore, in performance-focused management, the external environment is widely believed to have a major impact on organization performance. Some researchers have argued that the degree of congruence between an organization and its environment is one of the critical factors affecting performance. Burns and Stalker (1961) suggested that the success of a firm stems, in part, from the adoption of an organizational structure sufficient to deal with changing competitive circumstances. Child (1975) observed that the higher the performance, the greater the number of structured activities demonstrated, particularly in a stable environment.

2.6 Summary

Considering the above literature, there is vivid evidence that budgeting process have a certain effect on performance. In parastatals where a highly participatory with a widely consultative elaborate budgeting process performance is still poor; this leaves many unanswered questions in regard to the impact and real attributes of budget performance. This therefore was the motivation called for this research to be carried out. A critical review of the literature on budgeting is necessary to help the researcher and the readers to develop a thorough understanding of and insight into previous research that is related to the questions and objectives of this study. Some previous research finds the positive effects of the formalized budgeting on financial performance. It is suggested that what is really needed is a fundamentally new approach to such important budgeting purposes as forecasting and resource allocation, performance measurement and control, an approach which incorporates a range of "alternative steering mechanisms" that especially promote empowerment, flexibility and knowledge sharing Hope and Fraser (1997).
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction
This section presents the methodology that was used in carrying out the study. This begins with describing the research design, sample population, sampling methods, data collection, data sources, measurement of variables, validity and reliability of instruments, data processing and analysis that will be employed in the study, limitations and contingency measures to be used.

3.2 Research Design
The study used descriptive research design as the data collected by the survey attempted to provide descriptive information. It also used analytical techniques where the researcher analyzed information already available and looked at the present state of affairs. This is because data to be analyzed was categorically nominal data and qualitative in nature.

3.3 Population and Sample
Cooper et.al (2003) states that population is the total collection of elements about which we made some inference. In Kenya as at June 2013 we had 33 commercial and manufacturing parastatals (Appendix II). Finance personnel are expected to respond as they are considered important in any organization and all of them have more or less budgetary responsibility during the budget setting. The questionnaires aimed to
inquire into the participants' personal opinion about the budgeting process and the financial performance of the sampled firms.

3.4 Data Collection

The study used both primary and secondary data. In this study, questionnaires function as a preliminary data collection technique providing primary data and empirical analysis in this study. The respondents’ perceptions on the study variables will be obtained from a self-administrated questionnaire conducted with staff involved in the budgeting process. The 33 self-administered questionnaires were either electronically or hand delivered. The questionnaire includes a combination of open-ended questions and closed-ended questions Dillman (2000). The standard formal language used in Kenya is English and all of the respondents who will be approached understand English. Secondary data will be done by desk research which leads to a wide literature review about previous research related to budgeting activities and the behavior of business firms. This is because these data is often guided by expertise and professionalism that may not be available to individual researchers or small research projects and also because of the breadth of data available. Financial statements from the firms also used. Integrating several models suggested by previous research leads to the creation of a new research model to reveal the relationship between the budgeting process and financial performance.

3.5 Data Analysis

According to Marshall and Rossman (1999) data analysis is the process of
bringing order, structure and interpretation to the mass data collected. Financial performance was analyzed by ratios as it helps identify organizational strengths and weaknesses by detecting financial anomalies and focusing attention on issues of organisational importance. It is a well-established tool to evaluate an organization's profitability, liquidity and financial stability Glynn et al,(2003). One measure of return on assets was calculated for each annual and three-year period for each company in the population. Variables were selected to represent each of the primary categories of performance. Since many alternative calculations of some variables are commonly accepted, the following is a brief description of the operationalization of each variable used in this research.

In order to determine the relationship between budgeting and financial performance regression analysis a regression methods was used. In addition descriptive data analysis was used for descriptive data obtained from questionnaires. Generally, descriptive statistics from SPSS gave numerical information regarding the extent of budgeting process in commercial parastatals, how the financial performance of Kenyan parastatals is, and the possible effect of their correlations.

The conceptual model in this study consists of the dependent variable financial performance, the independent variables being budget systems, budget participation, budget sophistication and budget controls and since a positive relationship is expected the regression model is used. An equation (Eq. 1-a) is shown below to reflect the
3.6 Data Validity and Reliability

According to Saunders et al. (2003), validity and the reliability of the data you collect, as well as the response rate you achieve, depend, to a large extent, on the design and the structure of your questionnaire. Validity of the instruments will be measured using the Content validity Index (CVI). Questionnaires will be sent to at least three experts to rate the relevance of the questions to the study variables using a four-point scale of relevancy, quite relevant, somewhat relevant and not relevant. Additionally, the questionnaire design is approached in two ways that is by adopting questions used in other questionnaires and secondly developing own questions. Questions used to measure variables such as budgetary participation, managerial performances are directly adopted from other research. The consistency of questions with previous literature is necessary if we intend to replicate or to compare research findings with another study. It is also more efficient and time-saving than developing your own questions, provided that you can still collect the data you need to answer the research questions and to meet the research objectives. For some questions, both positive
and negative statements are used. The answer of respondents can then be checked once again by re-reading and comparing both questions. However, some questions, such as budget process and participation and some items of firm performance are developed by the researcher. To determine the internal consistency and build confidence in the data collected and used, Cronbach’s Alpha test was employed to measure the reliability.
CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

The research objective was to establish the effects of budgeting on financial performance of commercial and manufacturing parastatals in Kenya. This chapter presents the analysis and findings with regard to the objective and discussion of the same. The findings are presented in percentages and frequency distributions, mean and standard deviations. Finally a correlation and regression analysis is performed on the results.

4.2 General Information

This section of the questionnaire sought to establish the operation period of the firm, existence of structured budgeting process for the firm.

Table 4.1: Age of firm's continuous operation

<table>
<thead>
<tr>
<th>Years</th>
<th>Frequency</th>
<th>Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 10</td>
<td>2</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>Over 10</td>
<td>21</td>
<td>91</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

The results in Table 4.1 on the age of firms researched on was that 9% have been in existence for less than 10 years while the remaining 91% of the firms had operated for more than ten years. The results mean that majority of the firms had been in operation long enough and this can be taken to imply that the firms have grown large enough to establish an effective budgeting process and also realize the benefits of budgeting on
organizational performance. In addition, with the majority of the firms having been in operation long enough and expanded their operation regionally and internationally, there will be high chance of the firms developing budgets of various decentralized divisions or operations which should work in such a way to create a synergy to the firm has a whole.

4.3 Descriptive Statistics

The descriptive analysis below shows the average, and standard deviation of the different variables of interest in the study. It also presents the percentile values of the variables which help in getting a picture about the maximum and minimum values a variable can achieve.

On the question of whether the companies surveyed had established a budgeting process, 100% of the firms answered in affirmative and this means that they will be able plan, involve members of staff, adopt modern budgeting process and also establish effective control mechanism. The existence of these budgets will be expected to influence the respondents in giving factual information on the questionnaire since they will be versed with the questions contained therein.

4.4. Budgeting Process in the Organizations

The respondents were requested to indicate the extent at which they use different budgeting process in their organization in a five point Likert scale. The range was ‘strongly disagree (1)’ to ‘strongly agree’ (5). The scores of strongly disagree have been taken to represent a variable which had mean score of 0 to 2.4 on the continuous Likert scale; (0 ≤ S.D <2.4). The scores of ‘moderate’ have been taken to represent a variable with a mean score of 2.5 to 3.4 on the continuous Likert scale: (2.5 ≤ M.E. <3.4) and the
score of both agree and strongly agree have been taken to represent a variable which had a mean score of 3.5 to 5.0 on a continuous likert scale; (3.5 ≤ S.A. < 5.0). A standard deviation of >0.8 implies a significant difference on the impact of the variable among respondents.

**4.4.1 Budget Planning**

As indicated in the table below, the budget planning process was found to influence to a greater extent the performance of the parastatals. The involvement of line managers in developing individual segment budgets (mean, 3.7391), the allowance or variance on various parameters in the budget (mean, 3.7826) and the specification of every managers activity during the budget process (mean, 3.6087) came is an equally important activity in the budgeting process that will help in the realizable of the organization objective.

**Table 4.2 Budget Planning**

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Budget planning</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Line managers are the most prominent people responsible for the budgeting for their individual departments which are then combined to form the master budget and this increases the sales growth potential for the period</td>
<td>3.7391</td>
<td>.81002</td>
</tr>
<tr>
<td>Top management communicate the budget plan to those preparing the budget plan and this helps in reduction of wastage of resources</td>
<td>4.2174</td>
<td>.59974</td>
</tr>
<tr>
<td>The allowance or variance to be made to the various parameters is specified in the budget for the period</td>
<td>3.7826</td>
<td>.67126</td>
</tr>
<tr>
<td>The managers responsible for every set of budget and how they should respond to any expected environmental changes is specified and this increases the realization of the firm financial performance</td>
<td>3.6087</td>
<td>.65638</td>
</tr>
<tr>
<td>The budgets originate at the lowest levels of management and is refined and coordinated at the higher levels</td>
<td>4.1739</td>
<td>.65033</td>
</tr>
<tr>
<td>Past data is used as the starting point for producing the budgets</td>
<td>3.6957</td>
<td>.82212</td>
</tr>
</tbody>
</table>

**Overall Mean**

| 3.872 |

### 4.4.2 Budget Participation

The findings indicated that the most important budget process that the respondents found to affect the performance of the firm is budget participation (overall mean 4.32). It was found that if the views of employees are incorporated then the level of realizing the targets in the budgets was going to be higher compared to when the budget is self imposed by the management. Thus the management of a firm should encourage employee participation in the budgeting process, a process which will involve setting targets that are achievable. This finding is similar to that of Joshi et al., (2003) who posited that budgetary participation is expected to be a crucial channel to improve the information exchange and sharing among all levels of management and
when this process is pursued by a firm, it is expected that the realization of the set target is improved. Further, the results under the budget participation process is such that when the budgets originate from the lowest levels of management (mean 4.1739), it can be better refined and coordinated at higher levels and this process lead to improved ownership of the budget process by the staff.

Table 4.3: Budget Participation

<table>
<thead>
<tr>
<th>Budget participation</th>
<th>Mean</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee participation in the budgeting process will enhance the success of the budget achieving its financial targets</td>
<td>4.6957</td>
<td>.47047</td>
</tr>
<tr>
<td>It improves information exchange and sharing among all levels of management and therefore enhancing the acceptability of the budget and consequently increases of the market share.</td>
<td>4.6087</td>
<td>.49901</td>
</tr>
<tr>
<td>It avoids a situation where budgetees deliberately seek to obtain approvable for easily attainable budgets or understate budgets</td>
<td>4.3913</td>
<td>.49901</td>
</tr>
<tr>
<td>Participation determines whether budgeting is really a an effective management tool or just a clerical device</td>
<td>4.5217</td>
<td>.51075</td>
</tr>
</tbody>
</table>
The participation process establishes a position of trust and confidence with subordinates and thus resulting on increased financial performance

<table>
<thead>
<tr>
<th>Overall Mean</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>4.32</td>
<td></td>
</tr>
</tbody>
</table>

4.4.3 Budget Sophistication

From the results, it was evident that the level of sophistication of the budget process was not a strong factor that will influence the performance of the organization. This implies that employing sophisticated budgeting techniques will help in the operational section of the firm and not the performance of the firm.

Table 4.4: Budget Sophistication

<table>
<thead>
<tr>
<th>Budget sophistication</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>The use of computers to assist in the budgeting process has increased its accuracy and therefore financial performance of the firm.</td>
<td>3.6087</td>
<td>.65638</td>
</tr>
<tr>
<td>The organization has offered training and development programs to the budget committee members to improve their competency process and this has led to accuracy of the budgets</td>
<td>3.5217</td>
<td>.79026</td>
</tr>
<tr>
<td>The adoption of financial modeling in the budgeting process has enhanced the accuracy of the budget plan</td>
<td>3.5217</td>
<td>1.08165</td>
</tr>
</tbody>
</table>
The employment of computers in the budgeting process has improved the inter-department information transfer which also lead to improved performance of the firm

| Overall Mean | 3.532 |

### 4.4.4 Budgetary Control

Budgetary control was found to be another factor that will determine how an organizational budget is going to influence the performance of a firm. Budgetary control (overall mean, 3.761) was identified has an important component in the budget process. It is important that a feedback mechanism is introduced in the budget process which will help in flagging of any deviating results or activities that will not cause the overall organizational objectives and performance not to be achieved. The budgetary control involve determination of the budget variance which helps in adoption of management by exception strategy and therefore relieving the managers to concentrate on other pressing issues (mean, 3.8261), operational control which takes the form of evaluating the actual cost expense against the plan and taking the corrective action where necessary (mean, 3.7391) and linking the strategic planning and operational control.

**Table 4.5: Budgetary Control**

<table>
<thead>
<tr>
<th>Budgetary control</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Determination of the budget variance helps in adoption of management by exception strategy and therefore relieving the managers to concentrate on other pressing issues</td>
<td>3.8261</td>
</tr>
</tbody>
</table>
Budgeting control enables the organization to achieve its targets much easily since it helps in aligning the actual results to the plan.

The management control practice in the organization helps in linking the strategic planning and operational control.

The operational control in the organization takes the form of evaluating the actual cost expense against the plan and taking the corrective action where necessary.

| Overall Mean | 3.761 |

### 4.5 Effect of Budgeting practices on organizational performance

The respondents were to give independent opinion of how budgeting affects the performance of various financial parameters and their results is represented in Table 4.6 below.

#### Table 4.6: Effects of budgeting on organizational performance

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on investment</td>
<td>3.9261</td>
<td>.77765</td>
</tr>
<tr>
<td>Market share growth</td>
<td>4.0435</td>
<td>.97600</td>
</tr>
<tr>
<td>Cost reduction</td>
<td>4.6522</td>
<td>.48698</td>
</tr>
<tr>
<td>Sales growth</td>
<td>4.2174</td>
<td>.90235</td>
</tr>
<tr>
<td>Liquidity</td>
<td>3.8696</td>
<td>.96786</td>
</tr>
</tbody>
</table>
The findings in table 4.3 above show that most of the firms consider the budgeting process to influence the cost position of the firm. The pointed that an effective budgeting process will reduce cost (mean, 4.6522), increase the sale level (mean, 4.2174) and also affect the market share of the commercial entities. However, it was found that the budgeting process had the least effect on the liquidity position of the firm (mean, 3.8696). With a standard deviation averaging 0.8 for most of the results, it indicates that there was a moderate variability among the respondents as to the extent of effect of budgeting on the financial performance of the firm.

4.6 Regression Analysis

The effect of the firms budgeting process on the financial performance (ROA) was also investigated from the results of the respondents. From Table 4.4 below, the established multiple linear regression equation becomes:

\[ Y = 67.860 + 2.861X_1 + 3.292X_2 + 2.020X_3 + 2.387X_4 \]

Table 4.7: Results of General Least Square

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
<td>Tolerance</td>
</tr>
<tr>
<td>(Constant)</td>
<td>67.860</td>
<td>44.209</td>
<td>2.614</td>
<td>0.011</td>
<td></td>
</tr>
<tr>
<td>X_1</td>
<td>2.861</td>
<td>4.461</td>
<td>0.108</td>
<td>1.038</td>
<td>0.302</td>
</tr>
<tr>
<td>X_2</td>
<td>3.292</td>
<td>5.389</td>
<td>0.039</td>
<td>0.381</td>
<td>0.704</td>
</tr>
<tr>
<td>X_3</td>
<td>2.020</td>
<td>4.390</td>
<td>0.020</td>
<td>0.189</td>
<td>0.850</td>
</tr>
</tbody>
</table>
Dependent Variable: ROA

Source: Researcher 2013

The coefficient of intercept C has a value (67.860) though it is insignificant at 95% confidence level that was applied in the analysis. The coefficient of budget planning (X₁) is 2.861 and is significant at 5% significance level. This means that a unit increase in the budget planning process will increase the ROA of the firm by 2.861 units. Of all the independent variables, budgetary participation was found to be one that affects the most the firms return on investment.

4.7 Summary and Interpretations of Findings
The budget process should consider the changes in the business environment. The need for flexibility was also supported by Mclaughlin (1992) who posited that a business budget must be flexible enough to change to suit the current environment and during the period, it must be constantly reassessed to adapt to changing market conditions such as new competition, price changes and personnel availability. As Eker (2006) also observed, participation by individuals will lead to greater group interaction, which will be a good thing if the individuals value their membership of the group and see the goals of the group as being collective targets that they all regard as desirable. This finding supports this position.
The key findings was that more formal budgeting planning promotes higher growth of sales revenues in the parastatals, more formal budgetary control leads to a higher growth of profit in parastatals and greater budgetary participation leads to better managerial performance.

The major contribution of the current research is the construction of a new conceptual framework to show how the budgeting process impacts the performance of parastatals. The conceptual model tells us that the formal budgeting process and budgetary participation are supposed to improve the performance of parastatals. In addition, this study not only contributes more empirical data to the existing parastatals research, but more importantly, gives some remarkable guidance in terms of budget activities to the inspectorate of parastatals dimensions of the formal budgeting process are expected to have a positive effect on performance of commercial and manufacturing parastatals.
CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the key findings of the study as well as the conclusions, limitations of the study, and recommendations for further research.

5.2 Summary

The primary data in this analysis was collected from the targeted firms. The population of study was commercial and manufacturing parastatals operating in Kenya. From the targeted population of 33 firms, the researcher successfully got data from 23 of the firms.

The findings of the study were that organizational budgeting process is an important parameter that influences the overall performance. The budgeting process was found not to be one off process but that the common practices carried out include budget planning, budget participation, budget participation and budgetary sophistication. These were found to be key determinants of the success of a firm’s budgetary process and it is therefore imperative that a firm allocates adequate resources into these functions to realize intended improvement in performance. What came out strongly from the results is that employee participation in the budgeting process resulted in greater success in actualization of the plan set out in a particular period. Budget participation therefore requires that the views of all departments of performance centres need to be considered and a top-down budgeting process are discouraged. It was found that ownership of a project by the employees results in success during implementation because the set targets were in the first place agreed by the staff and therefore during implementation, they will seek to meet
the targets as set by them. Performance evaluation based on agreed targets was better appreciated by the staff.

Strategic control was also found to be an important practice in the realization of the set plan by the organization. It is not enough to simply develop a budget that is not measureable and at the same time not building in a feedback mechanism that will show any deviation of the actual results from the budget. A feedback mechanism should show any budget parameter that has exceeded its set target by the set allowance. The study also revealed in case the strategies does not move in the same direction with its budgetary goals, the strategies should be reviewed in line with the budgetary goals or preparation of supplementary budget. The controls put in place by many of the respondents were found to be loose and therefore affect the utilization of resources budgeted for as there are no sufficient checks to ensure accountability. The budgeting process in many organization face the challenge regarding monitoring of the budget as they have few seconded few staff to undertake the monitoring and thus these may affect the controls which are intended to ensure that the budget is adhered to.

5.3 Conclusion

From the research findings and the answers to the research questions, some conclusions can be, made about the study.

Adoption of effective budgeting process has an effect in the success of the plans set as well as financial performance of the firm. It is also important that a firm should explore the need to adopt participation budgetary process where all the employees through there section heads, present their views which are then considered by the budgeting committee.
Such participation will increase the success of the budget. Budgetary control is also an important step in realization of the budgeted targets. Introduction of controls will facilitate effective utilization of resources which have been allocated in the budget are spent on the intended projects and thus improving its performance in relation to service delivery which is needed by a shareholders of the firm.

An organization should put in place budget practices which assist in accomplishing a principle and element of the budget process. A budget element typically has multiple practices associated with it. Budget practices must be clearly related to activities identified in the budget process. Success in implementing the principles, elements, and practices should not be measured by how rapidly they are incorporated into the budget process. Successful implementation is likely to take a number of years in order to build the necessary level of understanding among all participants. The findings indicates that budgetary procedures are an important aspect of an organization's budgetary system because they promote more positive attitudes and behaviors on the part of managers, supervisors and employers with budget responsibility, which ultimately will enable the organization to better accomplish its goals and objectives.

In addition, when implementing the organization's budgetary procedures, budgetary decision makers should involve unit managers through periodic communication and any deviation from the mean should be investigated considering the environmental changes that have occurred in the budget period. Budgetary procedures implementation addresses the extent to which budgetary decision makers, such as the manager's immediate supervisor, carry out the formal budgetary procedures in a way that is consistent with the manager's criteria for what is proper.
5.4 Recommendation for Policy and Practice

The parastatals should put in place tighter controls as an ineffective control will lead to the firms not being able to achieve the set targets as well as increased waste of resources. At the same time the number of staff involved in monitoring the budget should be assessed and if found not to cope with the work involved, then the organization should consider recruiting more staff. The staff should also be compensated handsomely by the firms so that their morale is boosted which is expected to improve the performance of the firms.

5.5 Limitations of the study

As with any study, this study has its limitations. First, the scope of the study is limited by its sample size and industrial coverage. Due to limited time and the difficulty to gain access to data, this study uses a modest survey to test all hypotheses. The total number of the firms in this study is 33. All firms are from one industrial sector. The second limitation of this study concerns the nature of self-reporting questionnaire data. Thornton (1968) argues that self-report measures of performance can be subject to leniency bias. The third limitation is that a growth percentage is used for sales revenue and profit measurement. A similar absolute growth in sales revenues and/or profit can, however, result in different growth percentages for small and big firms. Another limitation of this study is that the author did not fully address the impact of budgetary participation on all performance measures used in this study.

5.6 Recommendation for Further Research

The study confined itself to manufacturing and commercial parastatals in Kenya.
This research therefore should be replicated in all other parastatals in different sectors and also establish a time period relationship between improvement of budgeting process and performance of the organizations. It also only examined whether budgetary process significantly and positively impacts financial performance. Some previous studies on budget process and performance, however, also tried to test the relationship between process and budgetary performance or job satisfaction. Further research can be undertaken to test whether budgetary process also significantly impacts budgetary performance, job satisfaction, and job involvement. In addition, there is no attempt in this study to address whether non-financial performance will finally lead to improvement of the financial performance of parastatals.
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APPENDIX I

QUESTIONNAIRE

The questionnaire seeks to collect information on the effects of budgeting on financial performance of commercial and manufacturing parastatals in Kenya.

PART A: GENERAL INFORMATION

1) Name of the organization (optional).................................................................

2) For how long has your organization been operating?

   - Less than two years [ ] 6-10 years [ ]
   - 2-5 years [ ] Over 10 years [ ]

3) Does your organization have a structured and well budgeting process?

   Yes ( ) No ( )

4) Does the established budgeting process affect your organization’s financial performance?

   Yes ( ) No ( )

PART B: BUDGETING PROCESS IN THE ORGANIZATION

5) Please tick appropriately the extent to which your organization has been practicing the following budgeting process and its effect of the financial performance of the firm (use the scale below to tick the most appropriate response).

   5) Strongly agree; 4) Agree; 3) Moderate extent; 2) Disagree; 1) strongly disagree

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<th>Budgeting Process</th>
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<td>Budget Planning</td>
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<td>1 Line managers are the most prominent people responsible for the budgeting for their individual departments which are then combined to form the master budget and this increases the sales growth potential for</td>
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2. Top management communicate the budget plan to those preparing the budget plan and this helps in reduction of wastage of resources.

3. The allowance or variance to be made to the various parameters is specified in the budget for the period.

4. The managers responsible for every set of budget and how they should respond to any expected environmental changes is specified and this increases the realization of the firm financial performance.

5. A factor that will restrict the financial performance of the organization in that specific year is specified at the outset to facilitate.

6. The budgets originate at the lowest levels of management and is refined and coordinated at the higher levels.

7. Past data is used as the starting point for producing the budgets.

**Budget Participation**

1. Employee participation in the budgeting process will enhance the success of the budget achieving its financial targets.

2. It improves information exchange and sharing among all levels of management and therefore enhancing the acceptability of the budget and consequently increases of the market share.

3. It avoids a situation where budgetees deliberately seek to obtain approvable for easily attainable budgets or understate budgets.

4. Participation determines whether budgeting is really a an effective management tool or just a clerical device.

5. The participation process establishes a position of trust and confidence with subordinates and thus resulting on increased financial performance.

**Budgetary Sophistication**

1. The use of computers to assist in the budgeting process has increased its accuracy and therefore financial performance of the firm.

2. The organization has offered training and development programs to the budget committee members to improve their competency process and this has led to accuracy of the budgets.

3. The adoption of financial modeling in the budgeting process has enhanced the accuracy of the budget plan.
4) The employment of computers in the budgeting process has improved the inter-department information transfer which also lead to improved performance of the firm

Budgetary Control

1 Determination of the budget variance helps in adoption of management by exception strategy and therefore relieving the managers to concentrate on other pressing issues

2 Budgeting control enables the organization to achieve its targets much easily since it helps in aligning the actual results to the plan

3 The management control practice in the organization helps in linking the strategic planning and operational control

4 The operational control in the organization takes the form of evaluating the actual cost expense against the plan and taking the corrective action where necessary

6) The statements below describe the effects of the budgeting practices on organizational financial performance. Please indicate the extent to which your organization financial performance has been influenced by the budgeting practices adopted:

Key:

5) Very great extent  4) Great extent  3) Moderate extent  2) Low extent  1) Very low extent

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<td>1 Return on Investment</td>
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<td>2 Market share growth</td>
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<td>3 Total cost reduction</td>
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<td>4 Sale growth</td>
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<td>5 Financial liquidity</td>
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THANK YOU FOR YOUR TIME
LIST OF CORPORATIONS

Commercial/Manufacturing Corporations
1. Agro-Chemicals and Food Company
2. Chemelil Sugar Company
3. East African Portland Cement Company
4. Gilgil Telecommunications Industries
5. Jomo Kenyatta Foundation
6. Kenya Airports Authority
7. Kenya Broadcasting Corporation
8. Kenya Electricity Generating Company
9. Kenya Electricity Transmission Company
10. Kenya Literature Bureau
11. Kenya Medical Supplies Agency
12. Kenya Ordinance Factories Corporation
13. Kenya Pipeline Company
14. Kenya Ports Authority
15. Kenya Power
16. Kenya Railways Corporation
17. Kenya Safari Lodges and Hotels
18. Kenya Seed Company Limited
19. Kenya Wine Agencies
20. Kenyatta International Conference Center
21. National Cereals and Produce Board
22. National Housing Corporation
23. National Oil Corporation of Kenya
24. National Water Conservation and Pipeline Corporation
25. New Kenya Co-operative Creameries Ltd
26. Numerical Machining Complex
27. Nzoia Sugar Company
28. Postal Corporation of Kenya
29. Pyrethrum Board of Kenya
30. School Equipment Production Unit
31. South Nyanza Sugar Company
32. Telkom Kenya Limited
33. University of Nairobi Enterprises and Services Limited

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