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Relationship between Master Budget Preparation and Profit ability in Sugar Factories in Kenya, "A Case Study of Mumias Sugar Company Ltd"

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ABSTRACT

The study examined the relationship between budgeting and Profitability among Sugar Factories in Kenya, with particular focus on Mumias Sugar Company Limited (MSC LTD). The researcher chose MSC Ltd because it is the largest Sugar Factory in Kenya that produces 67% Kenya's locally consumed sugar. MSC Ltd has conducted retrenchments, pointing to poor profitability as a result of poor budgeting that precipitated an investigation on the ground. The independent variables of the study included Sales budget, Production budget, Costs of goods sold budget and Marketing and administrative budget in Mumias Sugar Company Ltd. The dependent variable was profitability. The research used a descriptive study design using stratified random sampling. Data was collected using Questionnaires whereas tables and graphs were used to analyze data. The findings are that participation of all stakeholders in budget planning was limited, limited time for budgeting was allotted, rates used were rather sub standard, standard costing was missing, a comparative study was required, dissemination of budget planning information was limited and budget education to its employees missed and employee retrenchment has adversely affected the profitability of the company. The conclusion of the study revealed that there is a positive relationship between budgeting and profitability.

KEYWORDS: ***Budgeting, Sales Budget, Production Budget, Cost of Goods Sold Budget, Marketing and Administrative Budget, Profitability***.

1.0 BACKGROUND/INTRODUCTION

Horngren and Foster (1997), state that budgeting is becoming increasingly important, growing in prominence in the operations of both profit seeking and non-seeking organizations. Because of perpetual changing technology and management information systems globally; academicians, strategists and stakeholders are being challenged to consider budgeting as a contemporary factor on which other organizational factors cluster. Wangare (2006), states that MSC Ltd is the largest sugar factory in Kenya and produces 65% of the locally consumed sugar. It has the most competitive remuneration

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package among all sugar factories within the Republic of Kenya. It falls under group "B" according to the ranking of factories in the industrial sector. MSC Ltd is the key of Kenya as far as production of sugar for local consumption and export purposes are concerned.

MSC Ltd has won several awards. It earned awards as best company in environment management and marketing in 2006. The CEO, Dr. Evans Kidero was declared CEO of the year during the same period. In 2005, MSC Ltd earned best management awards performance and was ranked most respected company in East Africa in Agricultural services management. During the same period it acquired ISO 91001/2000 enabling it to sell its products anywhere in the world. In 2004, MSC Ltd was ranked the best company in corporative governance in the country. In 2002, MSC Ltd earned best award in human resource management. The organization is outstanding in the provision of corporative social responsibility (CRS) in the country through support in education, construction of roads, and support of agriculture, sports and games.

During the periods stated above (2002 – 2012), the company had a lot of retrenchments. This was attributed to adverse weather conditions, importation of cheap sugar, dysfunctional management and poor budgeting; particularly 2003 which was the exit of the management of the white CEO. In the same year the profitability of the company went into negativity and profit recovery was realized in 2004 – 2006, the period during which MSC Ltd reported the highest profits since its inauguration in 1973. This profitability was attributed to the entry of an African CEO who was vision driven and mission oriented.MSC Ltd is a subsidiary of BOOKER TATE international company based in the United Kingdom. It is situated in Western Kenya and it is about 53km from Busia boarder toward the eastern direction from Busia town of Kenya.

Oringe (2006), states that MSC Ltd has a vision, mission and values.

Vision: To be a leading Kenyan manufacturing company that efficiently and profitably produces and markets sugar and related products to world class standards.

MISSION: To satisfy customer needs for sugar and other products through efficient and innovative production and marketing practices while meeting the diverse expectations of all stakeholders.

Values:

To consistently offer quality products and services to customers, being a customer driven company, to encourage team work and positive contribution from motivated and innovative work force. To contact business with employees, customers and other stakeholders in an honest, fair and caring manner and to have an equal opportunity employer guided by international labour organization conventions, to practice fair competition, to at all times observe good corporative governance and to uphold excellence in performance as the basis of employee rewards. To be caring and supportive to the local community and to embrace internationally accepted health, safety and environmental practices in operations.

2 .0 PROBLEM STATEMENT

There was no proper budgeting in relation to profitability at MSC Ltd from 2002 – 2006 Webi (2006). This scenario seems to adversely affect profitability, which is evidenced by the employees` outcry owing to rampant retrenchment schemes that have seen so many workers out of the company from during the period in question. Being part of the MSC Ltd stakeholders, no definite explanation has been given to them as contributing to this anomaly. Whereas those who are retrenched are given their terminal benefits, the remaining employees are living in fear and

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unaware of their fate. Some employees attribute this situation to poor profitability due to poor budgeting, while some feel both profitability and budgeting are in place but the move is particularly tribal and aimed at clearing a specific species Wangara (2006).

Although there are five other sugar factories in Kenya that have a similar problem, the researcher chose MSC Ltd in particular because it is the largest sugar factory in the country and produces 65% of Kenya`s locally consumed sugar. The study looked at budgeting and how this influences profitability at MSC Ltd. The comprehensive study of MSC will be representative of all other sugar factories in Kenya. MSC Ltd is also the focal point of the Government of Kenya and back bone of Kenya Sugar Board Authority. This and other related factors have precipitated this study.

3.0 GENERAL AND SPECIFIC OBJECTIVES/ RESEARCH QUESTIONS

3.1 General objective

The general objective is to examine whether budgeting enables MSC Ltd to achieve profitability.

3.2 Specific objectives

1. To establish the relationship between sales budget and profitability at MSC Ltd.
2. To examine the relationship between production budget and profitability at MSC Ltd.
3. To examine the relationship between costs of goods sold budget and profitability in MSC Ltd.
4. To determine the relationship between marketing and administrative budget and profitability MSC Ltd.

3.4 Research questions

1. What is the relationship between sales budget and to profitability at MSC Ltd?
2. What is the relationship between production budget and profitability at MSC Ltd?
3. Does MSC Ltd prepare costs of goods sold budget to enhance profitability?
4. Does MSC Ltd prepare marketing and administrative budget to enhance profitability?

4.0 HYPOTHESES

1. There is no significant relationship between sales budget and profitability among sugar factories in Kenya.
2. There is no significant relationship between production budget and profitability among sugar factories in Kenya.
3. There is no significant relationship between costs of goods sold budget and profitability among sugar factories in Kenya.
4. There is no significant relationship between marketing and administrative budget and profitability among sugar factories in Kenya.

5.0 LITERATURE REVIEW

Master budget preparation and profitability at MSC Ltd

Pandey (1998) clarifies that a comprehensive budgeting involves the preparation of a master with a complete package of the component budgets. The three important components of the master budget include: operating budgets, financial budgets, and capital budgets.

According to Garrison and Noreen (2002), the master budget is a network consisting of many separate budgets that are independent.

Edmonds et. Al (2000), states that the master budget consists of a series of detailed schedules and budgets that describe the company`s overall financial plans for the accounting period. The three major budget categories are: operating budgets, capital budgets and financial statement budgets. The budgeting process normally begins with the preparation of the operating budgets. Preparation of the master budget begins with the sales forecast. The detailed budgets for inventory purchases and operating expenses are developed on the basis of projected sales. Information

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contained in the operating budgets is used to prepare the financial statement budgets. Again, the number of financial statement budgets also called Performa statements, depend on the nature and needs of the budget entity.

They continue to maintain that the budgeting process normally begins with the preparation of the operation budgets. An operating budget is prepared by individual sections within a company and becomes part of the company`s master budget.

According to Hilton et.el (2003), a master budget or profit plan is a comprehensive set of budgets covering all phases of an organization`s operations for a specified period of time.

Horngren and Foster (1997), state that the preparation of the master budget is fundamentally nothing more than the preparation of familiar financial statements. Preparation of a master budget involves preparing necessary schedules, namely: sales budget, production budget, cost-of-goods sold budget, and marketing and administrative expense budget.

Sales budget

Hilton et al (2003), state that the starting point for any master budget is a

Sales revenue budget based on forecasted sales of goods or services. Sales Forecasting is the process of predicting sales of services and goods. Sales forecasting depends on factors such as, past sales and trends, general economic trends, economic trend in the company, other factors expected to affect sales in the industry, political and legal events, the intended pricing policy of the company, planned advertising and product promotion, new products contemplated by the company or other firms, expected actions of competitors and market research studies.

According to Edmonds et al (2000), the preparation of the master budget begins with the sales forecast. The accuracy of the sales forecast is critical because it acts as the data source for all of the other budgets. If the sales figures are unreliable, the entire budgeting process is a waste.

Affirmatively Garrison and Noreen (2000), state that the sales budget is the starting point in preparing the master budget. The sales budget is constructed by multiplying the budgeted sales in units by the selling price.

Production Budget

Garrison and Noreen (2002), state that the production budget is prepared after the sales budget. The production budget lists the number of units that must be produced during each budget period to meet sales needs and to provide for the desired ending inventory. Production needs can be determined as follows;

Budget sales in units, Add desired ending inventory equals Total needs less beginning inventory equals required production.

Pandey (1998) affirms that production budget is prepared after the sales budget. It is based on sales forecasts to prepare after the sales budget. It is based on sales forecasts tp prepare the production’s budget; the sales forecasts for each product are combined with information about the beginning level and the expected level of ending inventories of the finished products. The units of budgeted products may be calculated as follows:-

Budget Production Units = Sales Estimate + Expected Ending Inventory – Beginning inventory

Hilton et al (2003), maintain that production budget shows the number of services or goods that are to be produced during a budget period. Production budget is ascertained but following formula;

Sales in units + Desired inventory of finished goods = Total units required;

Total units required – Expected beginning inventory of finished goods = Units to be produced.

Cost-of-Goods – Sold Budget

Hilton et al (2003), state that the budgeted schedule of cost of goods manufactured and sold

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details the direct material, direct labour, and manufacturing overhead costs to be incurred and shows the cost of goods to be sold during a budget period.

Marketing and Administrative expense budget.
According to Garrison and Noreen (2002), the selling and administrative expense budget lists the budgeted expense budget lists the budgeted expenses for areas other than manufacturing. In large organizations, this budget would be a completion of many smaller, individual budgets submitted by department heads and other persons responsible for selling and administrative expenses. For example, the marketing manager in a large organization would submit a budget detailing the advertising expenses for each budget period.

They affirm that the selling and administrative expense budget contains a list of anticipated expenses for the budget period that will be incurred in areas other than manufacturing. The budget will be made up of many smaller, individual budgets submitted by various persons having responsibility for cost control in selling and administrative matters. If the number of expense items is very large, separate budgets may be needed for the selling and administrative functions.

Profit
According to Crystal and Lipsey (1997), a firm`s profits are the difference between the revenue it receives from selling its outputs and its costs of producing and selling products. Firms seek profits by producing and selling products. The materials and factor services used in the production process are called inputs and the productions that emerge are called outputs.

The main objective of a business is to maximize its profits. The conditions for profit maximization are practiced and implementable in a wide range of different business situations. Basically, for profit to be a maximum there has to be equality incremental costs and incremental revenues, (equality of marginal costs and marginal revenues) which is achievable through budgeting? Saleem (2001), states that profit is the difference between selling price and cost of production.

Khan and Jain (2001), state that budget is an important tool of profit planning, are closely related to the broader system of planning in an organization. Planning involves the specification of the basic objectives that the organization will pursue and fundamental policies that will guide it.

According to Garrison and Noreen (2002), a budget is a step taken by the business organizations to achieve their desired levels of profits. This process is generally called planning. Profit planning is accomplished through the preparation of a number of budgets, which when brought together, form an integrated business plan known as the master budget. The master budget is an essentially management tool that communicates management's plans throughout the organization, allocates resources, and Co- ordinates activities'.

Edmonds et al (2000), state that planning is critical to the operations of a profitable business. The area of planning that is associated with financial matters is commonly called budgeting: which involves coordinating the finances of all areas of the business. The planning or budgeting area of an organization is responsible for the profits organizations make or achieve.

6.0 THEORETICAL FRAMEWORK.
This study is based on the planning and control theory of Fayol as advanced by Welch et. al (2001). This theory states that the future destiny of the enterprise can be manipulated; hence it can be planned and controlled by management. The concept of comprehensive profit planning and control rests firmly upon the planning and control theory; that is, the primary success factor in an enterprise is the competence of management to plan and control enterprise activities. Management

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earns its bread and butter only if it can plan and control in ways that determine the long-range destiny of the enterprise.

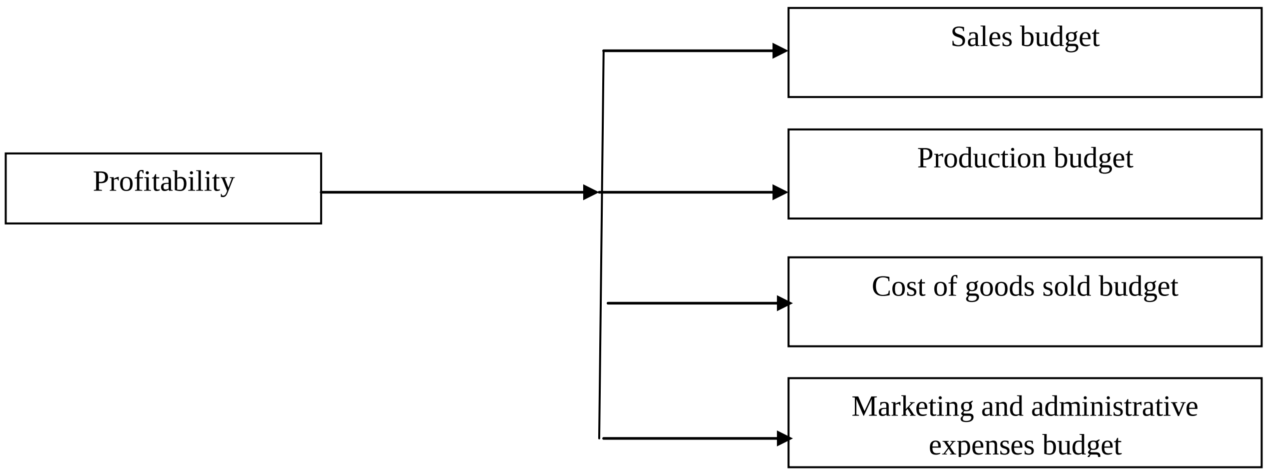
The foundation of profit planning and control, then, is that management must have confidence in its ability to establish a realistic objective and to devise efficient strategies to attain those objectives. Management can plan and control the Longer-range destiny of the enterprise by making a continuing stream of well-conceived decisions.

In the words of Griffin (2002), strategic plans are the plans developed to achieve strategic goals. More precisely, a strategic plan is a general plan outlining decisions of resource allocation, priorities and action steps necessary to reach strategic goals. These plans are set by the board of directors and top management; generally have an extended time horizon and address questions of scope, resource deployment, competitive advantage, and synergy.

7.0 CONCEPTUAL FRAMEWORK

This conceptual framework shows the relationship between budgeting and profitability in various budgeting units that form up a master budget. The units are a reflection of a step by step model of master budget preparation shown below:-

Dependent variable **Independent variables**



8.0 RESEARCH METHODOLOGY

8.1 Research Design

This study employed descriptive survey method to examine the relationship between budgeting planning and profitability at MSC Ltd. This design was considered because of its ease to collect original data from the population.

8.2 Target Population

MSC Ltd. has 1949 regular employees. 100 questionnaires were prepared and administered to 100 employees that included Heads of departments, line managers, superintendents, supervisors and general staff to examine the relationship between budgeting planning and profitability at MSC Ltd.

8.3 Sampling Technique And Sample Size

Respondents were selected from each stratum within the organization at senior, middle and lower levels to constitute a sample. Stratified random sampling was used to select the respondents that included; Heads of departments, line managers, superintendents, supervisors, and general staff, all totaling to one hundred (100).

8.4 data collection methods

Primary data was collected by use of structured questionnaire while secondary data was obtained

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from the Chama's Faulu branch administrative files.

8.5 Data Analysis

Questionnaires were developed with both closed and open-ended questions. The questionnaires were presented to MSC Ltd in person. After being filled, they were sorted out and results were compared and analyzed accordingly. The researcher used the computer program SPSS (Statistical Package for Social Science) to process and analyze data. The data was manually entered and stored in the SPSS worksheet and by the advantage of Statistical tests excel analytical tools, information was generated through graphical presentations and statistical inferences.

9.0 RESEARCH FINDINGS

Table 1-9: Showing respondents` understanding of MSC Ltd Preparation of sales budget

N=100

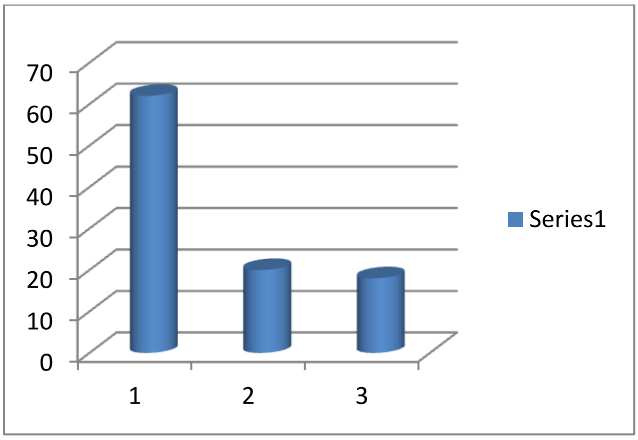
S/N	Alternatives	Frequency	Percentage
1	Yes	67	67%
2	No	13	13%
3	Not sure	20	20%
	Total	**100**	**100%**

Source: Field data (MSC Ltd)

The study established that 67% of respondents understand that MSC Ltd Prepares a sales budget, 13% has no understanding and 20%are not sure. This information assisted in assessing that MSC Ltd prepares a sales budget. This agrees with Hilton et al (2003), who maintains that sales forecasting is the process of predicting sales of sources and goods.

When asked to give their comments on their understanding of MSC Ltd Preparation of production budget, they gave their responses as follows:

Figure 1-9: Bar Graph showing respondents` understanding of MSC Ltd Preparation of production budget



Source: Field data (MSC Ltd)

The research found out that 62% of respondents understand that MSC Ltd Prepares a production budget, 20% said no while 18% of the respondents are not sure. This research helped in assessing that MSC Ltd prepares a Production budget. This concurs with Garrison and Noreen (2001) who affirm that the production budget is prepared after the sales budget

Table 1 – 15: Respondents' understanding of MSC Ltd Preparation of cost of goods sold budget

N=100

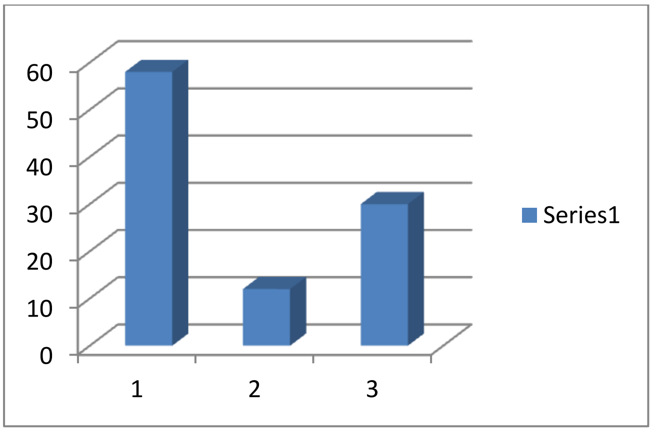
S/N	Alternative	Frequency	Percentage
1	Yes	60	60%
2	No	15	15%
3	Not Sure	25	25%
	Total	**100**	**100%**

Source: Field data (MSC Ltd)

This study found out that 60% of the respondents understand that MSC Ltd prepares cost of goods sold budget, 15% have no knowledge while 25% are not sure. This indicates that MSC Ltd prepares a cost of goods sold budget. This is in agreement with Hilton et al (2002), who affirm that the budgeted schedule of cost of goods sold should be prepared detailing the direct material, direct labor and manufacturing overhead to be incurred during a budget period.

The respondents' understanding of preparation of marketing and administrative expenses budget at MSC Ltd is as presented on table 1-16 below:

Figure 1–13: Bar Graph showing respondents' understanding of preparation of marketing and administrative expense Budget at MSC Ltd



Source: Field data (MSC Ltd)

The study established that 58% of the respondents understand that MSC Ltd prepares a marketing and administrative expenses budget, 12% have no knowledge while 30% are not sure. This information indicates that MSC Ltd prepares a marketing and administrative expense budget. This concurs with Garrison (2002), who maintains that a marketing and administrative budget should be prepared containing a list of anticipated expenses for the budget period during manufacturing.

Table 1-20 respondents' understanding whether budgeting enables MSC Ltd earn profit

N=100

S/N	Alternatives	Frequency	Percentage
1	Yes	61	61%
2	No	12	12%
3	Not Sure	27	27%
	Total	**100**	**100%**

Source: Field data (MSC Ltd)

The study revealed that 61% of respondents understand that budgeting enables MSC Ltd to earn profits, 12% have no knowledge while 27% are not sure. This data indicates that MSC Ltd earns profits due to good budgeting. This concurs with Pandey (1998) who states that budgeting develops an atmosphere of profit Mindedness and cost control consciousness.

Respondents' responses concerning MSC Ltd reporting of profits (2002-2006) were as follows:

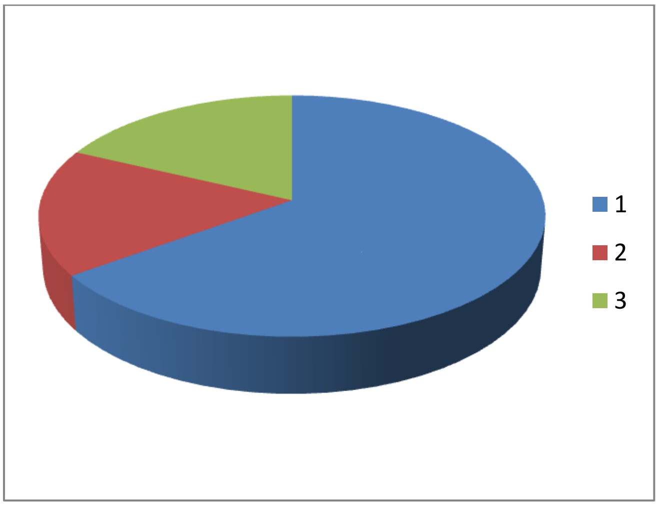
Table 1-21: Showing whether MSC Ltd had been reporting profits (2002 – 2006)

N=100

S/N	Alternatives	Frequency	Percentage
1	YES	65	65%
2	NO	17	17%
3	NOT SURE	18	18%
	TOTAL	**100**	**100%**

Source: Field data.

Figure 1-19: Pie chart showing respondents` understanding whether MSC Ltd has been reporting profits in 2002-2006**.**



Source: Field data (MSC Ltd)

The study established that 65% of respondents understand that proper budgeting has enabled MSC Ltd earn profits (2002-2006), 17% have no knowledge while 18% are not sure. This information helped in establishing that MSC Ltd

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has been earning profits from 2002-2006. This concurs with Pandey (1998), who states that budgeting is an important tool for profit planning in an organization.

When researcher perused through the natural sweetness journal to check on budgeted vs. actual earnings of MSC Ltd, it was revealed as follows;

Table 1-22: Budgeted and actual earnings of MSC Ltd between 2002-2006 in '000 of Ksh

YEAR	BUDGETED EBIT	ACTUAL EBIT
2002	116,167	104,552
2003	272,062	-244,856
2004	1,265,055	1,138,550
2005	2,048,201	1,843,381
2006	2,466,543	2,219,889

Source: Natural Sweetness Journal

This study has helped in determining that MSC Ltd earns profit due to budgeting. This concurs with Pandey (1998), who states that budgeting is a tool towards profit sustainability. In a general sense MSC Ltd achieves 90% of its budgeted income.

It is established that in 2003, MSC Ltd incurred a significant loss of Ksh 244,856,000 from poor budgeting and adverse weather conditions. This necessitated making several adjustments in budget planning to increase on profitability.

10.0 CONCLUSIONS AND RECOMMENDAT - IONS

The findings of the research reveal that MSC Ltd really embraced budgeting. This is evidenced by respondents' responses which pointed out vividly that MSC Ltd carries out budgeting before setting out any operations. All interviewed staff members, for example Heads of Departments, line Mangers, Superintendents, Supervisors, and general staff consent that MSC Ltd prepares a master budget. The study has also established that MSC Ltd earns profit due to its budgeting and that without proper budgeting MSC Ltd cannot be held together. In a similar development, the study found out that MSC Ltd employees have profound knowledge and exhibit a lot of understanding about budgeting which was established by the way they answered research questions.

The research findings also revealed that there is a positive relationship between budgeting and profitability. If proper budgeting is practiced profitability is likely. According to Khan and Jain (1998), budgets are an important tool of profit planning and budgets as a tool of planning, is closely related to the border system of planning in an organization. Saleem (1998) maintains that budgeting increases the morale and thus, the productivity of the employees by seeking their meaningful participation in the formulation of plans and policies, bringing a harmony between individual goals and the enterprise objectives more effectively thereby enhancing Profitability. Budgeting is thus a ship through which profitability sails.

Based on the findings of the research, the following recommendations are necessary for effective budgeting at MSC Ltd so as to increase profitability and not compromising quality. The research revealed that there should be Participation of all stakeholders, Addition of more time for budgeting, Use of standard rates, Adoption of standard costing and Budget comparison with other companies. It also revealed that there should be Dissemination of Budgeting information, Budget Education, Communication of Budget information to employees and Reduction of employee retrenchment.

Areas of Future Research

These research findings have created more questions than the study has tried to answer. They are not complete in themselves but are subject to further research, challenges and disapproval. Some of the areas that can be researched on include: Determining the relationship between budgeting and performance of employees,

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Examining profitability achievement through employee motivation, examining the relationship between profitability and corporate social responsibility in an organization. If the above recommendations were implemented MSC Ltd would realize the highest Profits ever and create prosperity for the people of Kenya through effective budgeting and implementation process.

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