Company Performance Measurement by Sample Budget Application

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Abstract

Today, the competitive environment of the trade companies, the gaining of the economic scale of the firms and the deepening of the globalization in economic sphere have made the future more ambiguous for trade companies. This complex environment has led companies facing profit to face serious risks on the other hand.

In Turkey, we can often refer to a structure that is severely depressed by family businesses. Most of these companies are not institutionalized, especially in the small to medium-sized ones. The concept of institutionalization is often perceived as the execution of jobs by professionals. In this regard, however, the company's board of directors is reluctant to transfer authority and does not transfer its authorities to professionals. It is not possible for institutionalization to take place in this form of a profound structure. As a result, it is unfortunate that these firms deserve concepts such as future planning, strategic planning, financial planning and budgeting.

Implementing business budgets, a tool that helps strategic planning and the company achieve its future goals, has a vital proposition in terms of businesses. Because if you do not have a goal, it is unclear where you will be in the future. As a result, in this paper it is expected that more than one sample budget to be prepared in different scenarios will contribute to the evaluation of firm performance.

Keywords*:* Family Companies, Institutionalization, Strategic and Financial planning, Budgeting

Introduction

Factors such as intensive domestic and international competition environment caused by globalization, company profitability under pressure of competition, significant volume of company mergers and acquisition and emerging giant economic size companies, and recent global economic crises experienced have decreased predictability of financial performances of companies. In an environment surrounded by threats and with less ambiguous future, it is now more important to adopt more proactive strategic understanding with budget planning for survival of companies. External environment bearing threats and uncertainties lead companies to face serious risks unintentionally as they maintain profit-oriented planning activities.

Except some certain large-sized companies, majority of companies are in “family business” form in Turkey. Managerial decisions made in family companies are usually based on personal and instinctive characteristics of business owners. Although there are some companies striving for institutionalization, these efforts do not pass beyond recruiting some senior professionals at administrative positions. However, the essence of institutionalization is to set business goals explicitly, setting growth plans in line with targets and to take measures against all risks that could threat company in the future. The most substantial tool that could be utilized by companies to that end is Annual Budget prepared within the outline of certain strategic plan.

Strategic planning is a process that could enable companies put all methods, applications and paths which facilitate acquiring projected position of the company in practice (Kulaç and Çeliktürk, 2016: 200). Budget, as an essential constituent of strategic planning, is tool which enable companies to foresee precautions that would be taken against different future circumstances or breakthroughs. Companies could be prepared for future opportunities or threats by setting different scenarios against awaiting constriction in resources, economic crises, financial and manufacturing bottlenecks, supply/demand fluctuations, new competitors in the industry, and eliminated competitors beforehand. Budgeting and budget-based reporting systems relying on these different scenarios are significant performance evaluation tools for companies.

In the first section of the present study, the concept of budget structure in businesses will be studied. In the second section, constituents of the budgeting process will be handled. In the third and the last section, projected income statement of a company operating in textile and agriculture produce industry in Denizli will be investigated within the scope of example budget structure prepared in Excel format; and factors effective on successful budgeting will be evaluated.

Budget Concept and Strategic Planning

In today’s intensive competitive and dynamic environment, it is in evitable for managers who are in an effort to shape companies’ future to utilize from planning and auditing tools for strategic planning and management. At this point, senior managers of companies undertake active role in setting future plans. Financial plans, growth plans, creating innovative product, entry into new markets and internal auditing plans could be given as examples prepared within this scope (Ritson, 2013:8). Budgeting, element of planning process, could be considered as a planning for businesses concerning where to find resources and how and when to uses these resources effectively for period of time a year or less (Lazol, 2004: 259)

In the contrary to past habits, businesses are required to employ various methods for success and survive in a competitive environment in globalizing world. Ever-changing conditions and transition into information society have differentiated these methods and elevated their significance. Budget, one of the tools preparing companies for future, could be considered as an executive plan prepared for effective usage of resources of a business and increasing their profitability (Tanç and Dikicioğlu, 2012: 138). Various functions of businesses such as sales, manufacturing, procurement and finance, require managers to make various decisions on daily and future activities of business. Irrelevant and discrete decisions would result in serious losses for business. In this sense, budget is a quantitative planning and auditing tool which handles different activities of business together, melts different administrative decisions in a single pot, and gives an idea about future activities of the business (Drury, 2001: 279).

Operating Budget

Today, businesses make budget for their various different needs. “Operating Budget” is considered as the one used by businesses for planning of their short-term activities. Operating Budget is an executive plan reflecting short-term activity predictions of businesses in quantitative form (Büyükmirza, 2005: 663). In other words, Operating Budget is a strategic planning activity which indicates targets set by a business for its different departments for a certain time horizon as well as the financial position, cash flows and profitability foreseen to be acquired at the end of the budgeting period relevant with whole business.

Although preparing operating budgets requires laborious effort, they have functions making significant contribution into businesses (Dickey, 2010: 7).

a) *Planning Function*: Budget is essentially a planning tool. Therefore, the objective of making budget is to set targets that would allow businesses to gain best results and the all relevant methods to be utilized in accomplishment of these targets (Yılmaz, 2001: 73).

b) *Auditing Function*: Budget is the most concrete auditing tool in businesses (Dickey, 2010: 7). Within the specific budget period, figures in the designated budget and the ones realized are compared so as to determine whether the business could accomplish its targets. During these comparisons, problematic subjects could be determined so that corrective measures could be taken against those determined problems which allow business could acquire period-end targets.

However, all authorities and responsibilities across a business are required to be designated and declared explicitly so that budget could be utilized as an auditing tool. Furthermore, policy, target and standards in a business are required to be determined in an inter-related fashion. Briefly, operating budget is fundamental plan of a company and covers a fiscal year usually. Operating budgets also include all income and expenditures relevant with the covered fiscal year (Barr, 2002: 35). Operating budgets are classified with respect to the subjects, the way of handling problems, their objectives, technical structures, scopes, initial figures and quantitative quality.

Budgeting Process in Businesses

Fundamental Constituents of Budgeting Process

For successful budget practices in a business, existing processes need to be defined clearly and managed carefully. In this context, foundation of divisions responsible for budgeting process within the organization, such as budget department or budget committee; provision of support to the relevant divisions by the senior management; and scheduling a budget calendar are considered necessary (Büyükmirza, 2005: 670). This project will be governed by a team established by members from each department of the organization body, whose responsibilities will be defined adequately and notified to the respective individuals.

The senior management is required to set its business vision and business targets relevant with the foresight period and notify the budget team. After this step, budget team needs to expose current status of business. Finally, budget targets and assumptions are required to be set and all respective divisions need to be notified (Kaygusuz and Dokur, 2005: 147). Basic components of the budgeting process are budget department, budget calendar, and budget period.

Budget Department

Participation of all departments across the business is substantially important for effective budgeting process and for realistic applicable results. The factor that needs to be taken into consideration basically during foundation of the budget division is that all departments that will contribute into the process should be competent in establishing communication and coordination for the process (Büyükmirza, 2005: 670).

Essential task of the budget division is to determine all procedures and methods that will be used in budget process; and to determine and obtain respective tools. The second task is assisting to resolution of issues related with technical, procedure and methods that could be encountered by any department in the organization. The third task is ensuring keeping up with the pace in preparation of estimations and predictions reported by all departments; combining budgeting studies reported by all departments so as to create general budget. Finally the fourth and the fifth tasks are performing comparisons between projected and realized budget items after the general budget is approved by the top management; and to prepare budget reports to submit top management and to the relevant departments (Büyükmirza, 2005: 670).

Structure and size of the budget division might differ from one business to another. Whereas it could be a crowded crew directly reporting to Board of Directors, CEO or General Chair in the large-sized businesses, it could be a chief division nested in accounting directorate in mid-sized businesses, or it could only be an accountant in small-sized businesses. However, regardless of the business size, they will be responsible for fulfilling all tasks mentioned above.

Budget Calendar

Budgeting activities are not implemented by a single department. Since they require participation of all departments across the business, delays caused by any point at any stage in the process would adversely influence the whole process. Therefore, budget process needs to be planned and scheduled thoroughly (Büyükmirza, 2005: 671).

The first step to be in budget calendar is determination of budget parameters. That is, environmental and business-inherent factors that could affect all budget predictions such as currency rates, inflation rates, growth rate and management’s business expectations for the relevant budgeting period business are required to be determined and the relevant departments should be notified.

As the second step, if this is the first budgeting period of the business, technical budgeting infrastructure and providing training to the associated users are needed. In the succeeding step, sales estimations, that is, sales budget needs to be made and other sub-budgets comprising o the general budget are to be made accordingly. After all budget estimations are drawn, budget estimations should be compared for evaluation pursuant to necessary corrections and amendments so that conformity among all budget items could be acquired. Coordination should be maintained continuously until evaluation and general budget are completed. Upon approval of the Board of Directors, the calendar will end for the budget period (Gökbulut).

Budget Period

Operating budgets are made as they cover certain time period. The length of this time interval depends on some variables such as type of business, utilization purpose of budget, specific conditions of the industry of the business and general conditions of the economy in which the business is operated. Prominent factors in determination of budget period are the Legal Accounting Period, economic stability, business policy and strategies, seasonal impact, associated risks with the business, finance, manufacturing and inventory control structures, structure and accessibility of available statistical data (Ataman and Hacırüstemoğlu, 1999: 351). If it is considered that legal accounting period of businesses in Turkey is one year and that majority of statistical data used in budget process is prepared for a year, it could be seen that the most common budget period is one year duration (Haftacı, 2005: 23).

Setting Operating Budgets

Operating budgets, or general budget, represent expectations of business management from the business for a certain period of time. These expectations include sales, manufacturing volume, all expenditures, all financial operations and value added. Budget could be assessed as a business plan for a certain period of time. Afterwards of this period, it becomes an effective tool to evaluate business performance (Shim and Siegel, 2005: 77).

Certain processes are involved in projection of operating budget; estimation of budget parameters (currency rates, interest rates, inflation rates, GDP growth rates and etc. relevant concerning the Budget Period) preparation of sales budget, procurement budget, investment budget, manufacturing cost budget, inventory budget, operation expenditure budget, cash flow budget and finally projected income statement and projected balance sheet (Shim and Siegel, 2005: 77).

Projected Income Statement and Projected Balance Sheet

In the present study, an example application will be presented for the Projected Income Statement and the Projected Balance Sheet prepared as a result of all other budget estimations (sales, procurement, inventory, department expenditures, investment, and cash flow budgets). The rationale lying behind this approach is that evaluation of the projected income statement and the projected balance sheet of a company will be adequate to assess performance of this company.

The projected income statement and the projected balance sheet could be considered as reflection of financial results of activities planned by a business for a certain budget period. They are important as a tool for predicting the extent of success associated with accomplishment of targets set by the business management in the beginning of the budget period (Ataman and Rüstemoğlu; 1999: 397). The projected income statement represents the operations targeted by the business management for a fiscal budget period. However, it is influenced by the results of the activities performed in the former periods. In parallel with the management needs, projected income statements could be prepared and reported quarterly or semi-annually (Shim and Siegel, 2005: 89).

Data summarized in the projected income statement constitutes foundation for the projected balance sheet, the terminal point of budgeting process. Balance sheet reflects both balance sheet values in the beginning of the period together with the figures as result of the concerned period (Ataman and Rüstemoğlu, 1999: 404). According to another description, projected income statement exhibits only expected incomes along the budget period. Projected balance sheet exhibits changes that could observed with the prepared budget and with assets and liabilities as a result of planned operations along the fiscal period. Therefore, contributions of business partners and/or owners to business assets and liabilities, return rate of the investment, could be estimated on the basis of projected balance sheet (Schaffer, 1988: 99).

Benefits of preparation of projected income statement and projected balance sheet could be enumerated as follows; allow adverse financial circumstances with businesses to take timely precaution; provide tool for quantitative confirmation of prepared budgets and accuracy of reports; allow various analyses such as profitability rate; and finally provide competency to foresee unexpected opportunities that could arise in the future (Shim and Siegel, 2005: 90).

Preparing Budget Report in Excel Form

In the beginning of the budgeting process, businesses are required to determine appropriate and valid budget parameters which could be described as estimations of future incidents with multiple event chance and result of non-business factors. Correct estimation of these variables that depend on environmental factors is significantly important for acquiring budget targets. Associated data could be classified in three main groups: parameters related with macro-economic - legal and social environment; industry-related parameters; and technology-related parameters.

Parameters related with macro-economic, legal and social environment include inflation rate (fluctuation in purchasing power of money), fluctuations in currency rate, changes in interest rates of loans, changes in interest rates of saving accounts and in return rates of investment funds, changes in taxing rates, legal changes that could influence business, potential changes in foreign trade policies, fluctuations in the GDP, demographical changes, and changes in government's investment and incentive policies and fluctuations in market demand. Parameters related with the industry include changes in market share of competitors, investment and growth policies of competitors, and their sales strategies. Finally, parameters related with technology include technological trends in the industry, reflections of these technological advancements to the country and new technology usage inclination of competitors (Güvemli, 1990: 114-116).

Of these parameters, the ones that could be measured quantitatively (currency, inflation rates, etc.) must be estimated monthly as budget parameter. Qualitative factors are required to be estimated accurately while determining budget targets and relevant business policies and strategies. Different targets and policies must be set for different scenarios. For instance, changes in demographical structure, that is, population increase and movements would affect consumer behaviors or employment conditions. In such framework, developing different strategies according to different population movement scenarios would play significant role in budget success (Güvemli, 1990: 116).

The company selected as the case for the purposes of the present study is in business of trading agricultural produce and manufacturing and trading of cotton yarn in Denizli, a significant agriculture and industrial city located in the Aegean Region. Due to the high environmental risks associated with the nature of agricultural sector and necessity of strategic planning and budgeting against these risk, this company was selected as a sample subject. The company's budget planning for 2007 and its realization rate were taken into consideration.

Table.1.

Cotton Sale Amount (1000 kg)	570	750	50	Bin $	1000 USD		Net Sales of %			Reel %
DECEMBER 1000 TL	2006 Actual	2007 Projected Budget	2007 Actual	2006 Actual	2007 Projected Budget	2007 Actual	2006 Actual	2007 Projected Budget	2007 Actual	F / F
Net Sales	**1.644**	**1.997**	**547**	**1.153**	**1.264**	**466**	**100%**	**100%**	**100%**	**-69%**
Domestic Sales	1.644	1.997	547	1.153	1.264	466	100%	100%	100%	-69%
Cost of Sales	**1.655**	**1.841**	**460**	**1.161**	**1.169**	**392**	**101%**	**92%**	**84%**	**-74%**
Gross Profit	**-11**	**156**	**87**	**-7**	**95**	**74**	**-1%**	**8%**	**16%**	**-875%**
Marketing, Selling Expenses	24	28	20	17	18	17	1%	1%	4%	-19%
General Administration Expenses	106	100	85	74	64	72	6%	5%	15%	-25%
Operating Profit	**-141**	**28**	**-18**	**-99**	**13**	**-15**	**-9%**	**1%**	**-3%**	**-88%**
Financial Expenses	-6	0	51	-4	0	44	0%	0%	9%	-974%
Income from other operations	13	22	-34	9	13	-29	1%	1%	-6%	-342%
Ordinary Profit	**-122**	**49**	**-104**	**-85**	**27**	**-88**	**-7%**	**2%**	**-19%**	**-19%**
Extraordinary Income and Profit	0		2	0		1	0%		0%	3793%
Profit for the Period	**-122**	**49**	**-102**	**-85**	**27**	**-87**	**-7%**	**2%**	**-19%**	**-21%**
Amortisation Expenses	15	21	19	11	13	17	1%	1%	4%	20%
Net Fund Amount	**-106**	**70**	**-83**	**-75**	**40**	**-71**	**-6%**	**3%**	**-15%**	**-26%**
EBITDA	**-125**	**48**	**1**	**-88**	**26**	**1**	**-8%**	**2%**	**0%**	**-101%**

Conclusion

The company set budget targets for 2007 on the basis of realized 2006 financial data. However, a serious deviation was experienced with budget targets at the end of 2007. The basic cause for this deviation was failure to consider all internal and external factors during preparation of a realistic budget.

The selected company is family business incorporated in Denizli. All decisions in family companies are taken with respect to their experience with the industry and their instinct. Although professional personnel are recruited in recent years, the last call is made by the business owner. In spite of the efforts spent by the examined company for institutionalization, these efforts have not gone beyond employment of some professionals at senior management level. Nevertheless, core objective of institutionalization is to ensure companies to gain a target-oriented structure so that it could be resistant against the risk threaten its persistence by means of planned growth. Budgeting, as a substantial and indispensible constituent of strategic planning, is the tool enables them to foresee precautions or breakthrough that could be encountered by companies in the future. For this purpose, the most important tools available for companies are strategic planning and appropriate budgeting. Companies could be prepared for future opportunities and threats such as resource depressions, crisis, monetary contraction, fluctuations in supply/demand, manufacturing bottlenecks, new players in competition, competitors gone out of business and etc. by utilizing from various scenarios.

Yet, decisions taken within the body of the family business in 2007 were not conforming to the strategic planning and budgeting techniques; and this situation resulted in serious deviations in budget targets. The company usually procures its row material of cotton from farmers in the Aegean Region. The management of the company who lacks strategic vision has failed to realize the contraction in cotton farming in the region over the years and decrease in cotton harvest so they failed to prepare an accurate budget in line with the observed contraction. While average amount of cotton yield in the Aegean region was 150,000 tons in the period of 2004-2005-2006, it fell to 116,000 tons by 2007. This decrease was observed gradually since 2001 (the cotton harvest figures were 227,862 tons, 218,809 tons, 194,556 tons, and 167,605 tons in 2001, 2002, 203 and 2004, respectively). Accordingly, the company management adopted a mistaken strategy by ignoring this negative development.

As it was observed with the company case, budget which does not include strategic planning dimension accounting for environmental factor and risks would be prone to deviations. In a successful budget preparation process, it is fundamental that objective and targets of company are required to be adopted by all employees, strategic planning must be institutionalized at all departments as the company culture. Therefore, budgeting process should not only include senior managers but also all employees are included in.

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