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EFFECT OF BUDGET PLANNING ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN NAKURU TOWN CENTRAL BUSINESS DISTRICT

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Abstract

Several Small and Medium Enterprises (SMEs) fail to make budgets; others do it but fail to constantly update their budgets and evaluate their progress against the actual budgets, or are disgruntled by the futility of the budgets prepared, or the budgeting process. Subsequently, most SMEs pay more attention to financial performance measures but disregard the more strategic non-financial indicators. This study sought to establish the effect of budget planning on financial performance of SMEs in Nakuru town C.B.D. It was guided by the Agency Theory, Balanced Scorecard Theory, Contingency Theory and Stakeholders' Theory and it adopted the descriptive research design. The unit of observation was SMEs within Nakuru town C.B.D. while the unit of analysis was business owners or officer in-charge of finance in the SME. Each SME produced one respondent who was either the owner or officer in-charge of finance. According to Nakuru East Sub-County Business Register (2018), there are 26,158 SMEs in Nakuru East Sub-County; 7,456 are located within Nakuru town C.B.D. and are classified into eight major categories. Nassiuma's (2000) formula was used to get a sample size of 108. It also adopted stratified random sampling to get the sample size of each SME category. The formula was appropriate to ensure equal probability of selecting each unit from the population being studied. The study further used purposive sampling to select the biggest SMEs in each category. This was informed by the fact that some of the small SMEs have no structures and rarely prepare budgets. Questionnaires were used to collect the primary data desirable for the study. Quantitative data was analyzed through the aid of Statistical Package for Social Sciences (SPSS) version 22. Descriptive and inferential statistics were used in data analysis. Descriptive statistics involved the use of percentages, frequencies, measures of central tendencies (mean) and measures of dispersion (standard deviation). The inferential statistics employed were Pearson's correlation coefficient and multiple regressions. The findings revealed that there is a moderate positive and statistically significant correlation between budget planning and financial performance. ($r = 0.443$; $p < 0.05$). The study recommended that budget review should be done as frequently as possible to increase the level of understanding. Also, evaluating major projects should be given priority for it increases reliability and accountability and makes the employees more knowledgeable on budget planning practices.

Keywords: *Budget planning, Participative budgeting, Budgetary monitoring, Financial performance*

I.INTRODUCTION

Budgeting as a management tool helps to organize and formulize management's planning of activities. Budgeting as a financial tool is useful for both evaluation and control of organizations for the planning of future activities (Kariuki, 2010). Budgeting in a business has benefits and consequences that go beyond the organization's management and have more to do with financial dimension in general, key of which is financial performance. Budgeting forces firm's management to do better forecasting. Vague generalizations about what the future may hold for the organization are not good enough for assembling a budget. Firm's management must put their predictions into definite and concrete forecasts (Tracy, 2013). Budgeting motivates managers and employees by providing useful yardsticks for evaluating performance. Budgets provide useful information for superiors to evaluate firm's performance and inform financial allocation strategies across various components of a firm (Horngren, 2013).

According to Dunk (2012), budgetary control is the process of developing a spending plan and periodically comparing actual expenditure against that plan to determine if it or the spending patterns need adjustment to stay on track. The process of budgetary control is necessary in ensuring that spending is controlled to meet various financial goals. Firms should rely more on budgetary control in order for them to control intra-firm spending activities. This technique is applicable both for the private and public sector institutions as well as individuals who want to make sure they live within their means.

The process of budgetary control is a management control process in which the actual income and spending are controlled viz a viz the planned income and spending so that the firm can make decisions if plans are being followed and if those plans need to be changed in order to make a profit. Organizations according to Epstein and McFerlan (2014) should use budgetary control in projections in order to plan for the future. Firms usually implement budgetary control techniques to prevent losses resulting from theft, fraud and technological malfunction. These techniques also help management to ensure that expenses remain within budgetary limits. The advantage of budgetary control is that it can be implemented by three departments within the firm in order to enhance efficiency and effectiveness.

Budgets are important to SMEs because they provide future-oriented information which facilitates monitoring and control of business performance (Hallsworth, 2015,). They do so by highlighting areas in which actual performance deviates from the budgeted (planned) performance, so that an appropriate corrective action can be taken (Akande & Oluwaseun, 2014). By so doing, budgets facilitate management by exception, as the decision makers are able to isolate problem areas that need urgent attention, an approach that results in effective problem resolution (Dima, 2013). In addition, budgets facilitate coordination and alignment of different departments within a business towards common objectives by providing a bigger picture of the desired objective pursued by an SME (Hill, 2015). By quantifying the desired objectives, budgets minimize confusion and create a common understanding of the objectives, thereby easing communication.

II.RESEARCH OBJECTIVES

(i) To assess the effect of budget planning on financial performance of small and medium enterprises in Nakuru town C.B.D.

III.RESEARCH HYPOTHESIS

The study tested the following hypothesis:

(i) $\mathbf{H_{01}}$: There is no statistically significant effect of budget planning on financial performance of Small and Medium Enterprises in Nakuru town C.B.D.

IV. LITERATURE REVIEW

Budget Planning and Financial Performance

Budget planning involves the use of budgets to develop financial forecasts, which can include cash budgets, sales budgets, operational budgets, capital budgets, strategic budgets, and budgeted financial statements (Bedford, 2015). Planning is an important function of business management. Budgets are the primary planning tool used in most organizations. To facilitate proper planning, the management team should define the patterns of expenditure and revenue over the life of the project or the activity that the organization is undertaking. A predetermined budget of possible cost that was incurred while carrying out the activities planned in a project should be made. Realistic planning of finances is key to the implementation of a project or programme (Joshi &Abdulla, 2016).

Sizer (2013) states that, planning as part of the budgeting system involves a long range planning, strategic planning and short term planning. Arora (2015) argues that planning involves selecting objectives and action to achieve them. It is looking ahead and preparing for it, which links it to budgeting. Through planning, the organization is able to assess where it is supposed to be in terms of objectives and goals. This comes from the information system. Sound planning mentions priorities and the planning control cycle. Since there are so many activities to be performed, it is imperative that they are listed in order of preference. Budgets are put in place in advance of the budget periods based on anticipated set of circumstances or environment.

The major decisions are made as part of the long term planning process. Benefits of budgeting accrue to the whole organization if both the short and long term consequences of the budgets are considered (Otley, 2015). However, the annual budgeting process leads to the refinement of those plans, since managers must produce detailed plans for the implementation of the long range plans. Without the annual budgeting process, the pressures of day-to-day operating problems may tempt managers not to plan for future operations (Scott, 2017).

Wijewardena and De Zoysa (2015) perceive that the impact of budget planning and budgetary control on performance may vary from firm to firm depending on the extent of its use. The greater extent of the formal budgeting process should have a positive impact on the performance of SMEs. In their study, performance is measured by two financial indicators: sales growth and return on investment. Data was collected from two thousand manufacturing SMEs in Australia. The results show a positive and significant relationship between budgeting planning and sales growth, and between budgetary control and sales growth. However, no significant difference was found between budget planning and return on investment (ROI), nor between budgetary control and return on investment.

Participative Budgeting and Financial Performance

Participatory budgeting has been used to describe a diverse range of activities, but there is a general consensus that it broadly refers to the process of involving citizens in decision making regarding the distribution of public funds (Harkins and Escobar 2016). Arnold & Sutton (2014) referred to budget participation as the process by which managers have influence on the setting of their budget goals, even if they are subsequently evaluated on them. In this study, budgetary participation refers to the extent to which managers participate in preparing the budget and influence the budget goals of their responsibility unit.

Wisegeek (2012) defines participative budgeting as a type of financial planning strategy that involves the active participation of a wider range of employees in the process of creating a workable budget for a department or even an entire company. Employees throughout the company structure are invited to provide inputs into the assessment of the company’s needs for the upcoming budgetary period. Participation in the budgetary process yields benefits such as increasing employee motivation and commitment to the budget fostering creativity among all levels of employees, increasing a sense of responsibility, increasing job satisfaction and also performance. Hence, participation is an essential part of effective budgetary planning and control and is the primary tool for reducing the dysfunctional effects of budgeting. However, budget goals should be negotiated through budget participation and be set at a tight but attainable level. Only this kind of budget goals can cause motivational effects that will increase the level of budget performance.

Shields and Young (2013) found that participative budgeting is used more frequently when lower level management and senior management within an organisation are linked to budget preparation and implementation. According to O´Toole and Meier (2011) most complex aspect of participatory budgeting that should matter for performance is, perhaps, the internal management of organizational operations (namely, from designing and operating information systems, including information technology, to managing financial resources, to motivating and leading cadres of public employees, and much more). Therefore, one strategy for making progress is to isolate one of these aspects that are amenable to measurement and then estimate its effects on organizational outputs and outcomes.

Abata (2014) conducted a study on participative budgeting and managerial performance in the Nigeria’s food products sector. The objective of this study is to measure the effect of participative budgeting on managerial performance. The study adopted a survey research design and a well-structured questionnaire was used to gather data from the different level managers of Honeywell Superfine Foods Limited in Lagos State. The findings revealed that there is a significant relationship that exists between managerial performance and participatory budgeting.

Obwaya (2011) conducted a study on the relationship between participatory budgeting and performance of local authorities in Kenya. The target population of this study was the sampled 44 respondents. The data received was analyzed by multiple regression analysis. The results of this study show that the increase in both organizational affective commitment and budget participation of subordinate managers may reduce some agency problems existing in the budgeting process. In the situation of high budget participation, subordinates with strong organizational affective commitment may reveal their private information about budget conditions, and may have no intention to create slack in their budget.

Faleti and Myrick (2012) carried out a study to determine the effects of budgetary participation on the employee’s performance of Nigeria’s ministries, departments, agencies and parastatals. A combination of financial and non-financial measurements was suggested to reflect the effectiveness of budgeting practice on employees performance. The findings provided more evidence regarding the impact of the budgeting process on employees performance, and suggestions for increasing employee performance level in Nigeria was provided, thus providing possible solutions to similar challenges faced by other developing countries.

Sugioko (2010) conducted a study to determine the impact of budget participation on job performance of University Executives: a study of APTIK- member Universities in Indonesia. This research aimed to test empirical evidence regarding the role of mediating variables on the impact of budget participation on job performance. The study concluded that budget participation has a positive and significant impact on job performance, while structural equation tests showed that, trust, organizational commitment, budget adequacy, and job satisfaction variables positively and significantly mediated the relationship between budget participation and the job.

Melek, (2007) did a study on the impact of budget participation on managerial performance via organizational commitment. He conducted a study on the top 500 firms in Turkey. The results of this study provided a number of contributions to management accounting literature by improving understanding of budget participation and organizational commitment affecting managerial performance. First; according to regression analysis results, this study suggested that the effects of budget participation and organizational commitment by itself on managerial performance are positive and significant. Second; this study found out that the managerial performance scores were found to increase when the interaction score between budget participation and organizational commitment increases.

Global Perspective of Budgeting among SMES

Small and Medium Enterprises are globally believed to fuel the economic development of the country and advance the possibilities of equitable growth. In India SME sector is central to her economy imparting 40% of exports and adding up to 45% of industrial production. Moreover it provides employment opportunities to approximately 60 million people and yearly creates 1.3 million jobs in India. According to the figures rendered by the Europe India SME business council, there are around 30 million Small and Medium Enterprises in India rapidly growing at 8% annual rate and they are estimated to produce jobs for millions of people in the country (Europe India SME business council, 2015). The latest growth of SMEs in India has been attributed to improved budgeting practices.

According to the National Development and Reform Committee (NDRC, 2014), formally registered SMEs represent more than 99.6 percent of all enterprises in China, accounting for 55.6 percent of GDP and 62.3 percent of imports and exports, and contributing 46.2 percent of tax revenues to the national economy. In China many private SMEs go bankrupt and the bankruptcy of SMEs in a period of three to five years is some 50 percent. This has been attributed to poor financial management such as the budgeting process (Wang, 2014). On the other hand, UK companies experienced eminent gains by careful planning of their budgetary functions and majority of the Australian companies have systemized and elaborated their budget controlling processes (Bonn & Christodoulou, 2016).

Budgeting among SMEs in Africa

Ghanaian Small and Medium Enterprises' (SMEs) contribution to GDP over the years cannot be underrated because of their ability to create employment opportunities, income generation and impact entrepreneurial skills that are critical for the alleviation of poverty and creation of wealth. According to Abor and Biekpe (2015), Ghanaian SMEs account for about 70% of industrial employment and well over 50% of the GDP. However according to Ghana Bank Doing Business Report, 2015 a large number of businesses fail due to the absence of budgeting rather than the absence of profits. Research has shown that 70% to 80% of SMEs in South Africa are not sustainable, most of them failing in their infancy stage (Mthabela, 2015).

According to the Global Entrepreneurship Monitor South Africa 2014 report, lack of access to finance and poor profitability, are among the chief reasons for business discontinuance in South Africa. The GEM report also pointed to the fact that poor profitability, as a reason for discontinuance, was rising sharply. Typical hindrances towards small businesses obtaining finance include: inadequate collateral on the part of the entrepreneur and lack of credit history (Financial Services Regulatory Task Group, 2007), the inability to produce an acceptable business plan according to financial institutions, poor market research and the absence of a viable business idea, and lack of access to vibrant markets (Global Entrepreneurship Monitor, 2014). The findings of the study revealed that some SMEs in the manufacturing industry in the Cape metropolis utilize budgets for managing their businesses. The SMEs however face challenges when applying budgets.

Budgeting among SMEs in Kenya

In Kenya SMEs operate in all sectors of the economy, that is, manufacturing, trade, transport, mining agriculture and service subsectors. The SMEs range from those unregistered, known as Jua Kali Enterprises, to those formally registered small-scale businesses, such as supermarkets, wholesale shops and transport companies. Almost two-thirds of all SMEs in Kenya are located in the rural areas with only one-third found in the urban areas (Statistics Kenya, 2010). Research by (Statistics Kenya, 2010) indicates a high business failure rate amongst start-up businesses in Kenya. These small businesses cannot be the platform for growth and development if they are not profitable and sustainable. One possible reason for this prevalence is that small business owners are not equipped to identify the problem areas within their businesses, due to lack of necessary skills and tools to increase profitability and sustainability. Likewise, many small business owners do not perform many cash management practices simply because they feel they are not necessary and are very time consuming (Debt, 2009). Despite the context in which budgeting is done, it has been identified as one of the factors that contribute to small business failure (National Bureau of Statistics, 2012).

V. RESEARCH METHODOLOGY

The study adopted descriptive research design. The unit of observation was SMEs within Nakuru town C.B.D. while the unit of analysis was business owners or officer in-charge of finance in the SME. Each SME produced one respondent who was either the owner or officer in-charge of finance. According to Nakuru East Sub-County Business Register (2018), there are 26,158 SMEs in Nakuru East Sub-County of which 7,456 SMEs are located within Nakuru town C.B.D. which are classified into eight major categories. The study used Nassiuma’s (2000) formula to get a sample size of 108. The study also adopted stratified random sampling to get the sample size of each SME category. The formula was appropriate to ensure equal probability of selecting each unit from the population being studied. The study further used purposive sampling to select the biggest SMEs in each category. This was informed by the fact that some of the small SMEs have no structures and rarely prepare budgets. Questionnaires were used to collect the primary data desirable for the study. Quantitative data was analysed through the aid of Statistical Package for Social Sciences (SPSS) version 22. Descriptive and inferential statistics were used in data analysis. Descriptive statistics involved the use of percentages, frequencies, measures of central tendencies (mean) and measures of dispersion (standard deviation). The inferential statistics employed Pearson’s correlation coefficient and multiple regressions.

VI.RESEARCH FINDINGS AND DISCUSSIONS

Budget Planning on Financial Performance of Small and Medium Enterprises

The respondents were asked to indicate their level of agreement on the effect of budget planning on financial performance of Small and Medium Enterprises in Nakuru town C.B.D. The findings were as indicated in Table 1.

Table 1: Budget Planning on Financial Performance of Small and Medium Enterprises

	SA %	A %	N %	D %	SD %	Mean	Std
The organization has long term and short term budget plans.	26	47	17	10	0	3.887	0.907
The organizations' budgets have clear goals and objectives.	37	45	13	5	0	4.113	0.870
The budgets cover all aspects of our mission.	55	42	3	0	0	4.516	0.565
When budgeting, outcome goals and objectives are linked to programmes.	57	37	6	0	0	4.500	0.621
The business set priorities for the coming year at budget conference/committees.	39	44	11	6	0	4.145	0.866
All the departments in our business prepare budget plans prior to the budget year.	45	37	13	5	0	4.226	0.857

According to the findings, 73% (72) of the respondents agreed that the business has long term and short term budget plans with a mean of 3.887. This is in agreement with Arora (2015) who argued that planning involves selecting objectives and action to achieve them. He concluded that through planning, the organization is able to assess where it is supposed to be in terms of objectives and goals. The findings further indicated that (82%) of the respondents agreed that the business budgets have clear goals and objectives with a mean of 4.113.

In addition majority of the respondents 97% (78) agreed that the business budgets cover all the aspects of our mission with a mean of 4.516. This agreed with Bedford, (2015) who agree that planning is an important function of business management. Budgets are the primary planning tool used in most organizations. To facilitate proper planning, the management team should define the patterns of expenditure and revenue over the life of the project or the activity that the organization is undertaking.

The findings further indicated that 94% (92) of the respondents agreed that when budgeting, the business outcome goals and objectives are linked to programmes with a mean of 4.500. In addition 83% (78) of the respondents agreed that the business set priorities for the coming year at budget conference/committees with a mean of 4.145. Finally 82% (78) of the respondents agreed that all the departments prepare budget plans prior to the budget year with a mean of 4.226. The standard deviation ranged between 0.565 to 0.907 indicating that the dispersion of the respondents from the mean was minimal. The study is in line with Sizer (2013) who argues that, planning as part of the budgeting system involves a long range planning, strategic planning and short term planning.

Table 2: Simple regression on Budget Planning on Financial Performance

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.038	.145		.260	.796
	Budget Planning	.233	.081	.245	2.877	.006

Dependent Variable: Financial Performance
Independent Variable: Budget Planning

The results of the study revealed that there was positive relationship between budget planning and financial performance. (β_1=0.233). To test the relationship the Regression Model fitted was $Y = \beta 0 + \beta_1 X_1 + e$. giving a model equation of $Y=0.038 + 0.233X_1 + e$. This implies that, a unit increase in budget planning, would lead to a 0.233 improvement in financial performance of SMEs in Nakuru Town. Sound budget planning enhance financial performance of SMEs. Since there are so many activities to be performed, it is imperative that they are listed in order of preference.

Pearson Correlation: Budget Planning on Financial Performance

The study sought to establish the effect of budget planning and financial performance of Small and Medium Enterprises in Nakuru town C.B.D. To find out this a person correlation was run and its results are presented in table 3.

Table 3: Budget Planning on Financial Performance

		Financial Performance
Budget planning	Pearson Correlation	.443**
	Sig. (2-tailed)	.001
	N	95

**. Correlation is significant at the 0.05 level (2-tailed).

From the findings r=0.443 meaning there is moderate positive correlation between budget planning and financial performance this is because it far away from +1 which is the value that indicated the strongest correlation. This reflects that effective budget planning improves the financial performance of SMEs. The study sought to test the hypothesis that: **H_{01}:** There is no statistically significant effect of budget planning on financial performance of Small and Medium Enterprises in Nakuru town C.B.D. From the findings the p-value was 0.001 which was less than 0.05 significant levels. Therefore, based on the rule of significance, the study rejects the null hypothesis **(**H_{01}**)** and concluded that budget planning has a significant effect on financial performance of Small and Medium Enterprises in Nakuru town C.B.D. The study agrees with Wijewardena and De Zoysa (2015) who argued that a positive and significant relationship exists between budget planning and sales growth, and between budgetary control and sales growth. The findings further revealed that through planning, the organization is able to assess where it is supposed to be in terms of objectives and goals. This comes from the information system. However, the annual budgeting process leads to the refinement of those plans, since managers must produce detailed plans for the implementation of the long range plans

VII.CONCLUSION OF THE STUDY

From the findings, the researcher concluded that when budgeting, outcome goals and objectives are linked to programmes. It was also noted that SMEs set priorities for the coming year at budget conference/committees. All the departments in SMEs prepare budget plans prior to the budget year. The results of the study revealed that there was positive relationship between budget planning and financial performance. ($\beta 1$=0.233). This implies that, a unit increase in budget planning, would lead to a 0.233 improvement in financial performance of SMEs in Nakuru Town. Sound budget planning enhances financial performance of SMEs. Since there are so many activities to be performed, it is imperative that they are listed in order of preference. The study is in line with Sizer (2013) who argues that, planning as part of the budgeting system involves a long range planning, strategic planning and short term planning.

VIII.RECOMMENDATIONS OF THE STUDY

The study recommended that budget review should be done as frequently as possible to increase the level of understanding and evaluating major projects to be given priority, also increases reliability and accountability as it makes the employees more knowledgeable on budget planning practices. Budgetary control process should consider both firm needs and parameters within the firm during planning to achieve better results. Budgets should be used both as indicators of management's performance as well as tools used by the firm to enhance its financial goals. There is need to actively involve all stakeholders in strategic planning as successful level change will only occur if supported by all stakeholders.

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