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1.0 INTRODUCTION

1.1 COMPANY BACKGROUND

ACM Pte Ltd, (ACM), is a commodity trading company dealing in cocoa beans and products. The company is part of the global cocoa trading operation of the AC Group, which is based in London. The AC Group trades in several soft commodities – cocoa, coffee, sugar and deals in the management of financial services. Within the Group, products are managed globally according to divisions. The cocoa division has 3 trading centres - in London, New York and Singapore to cover the three major geographical markets of Europe, the Americas and Asia.

ACM started operating in Singapore in June 1996. It sources cocoa beans from the Asian producers (principally via its buying centre in Sabah and through buying agents in Indonesia) and sells to customers in Asia. The customers are industrial users processing cocoa in Malaysia, Singapore, Indonesia and China. It also acts as a commission agent in cocoa products trading for other Group offices in the Asian market. ACM reports to the Group Head Office in London. The parent company, AC Limited is a public quoted company on the London Stock Exchange.

Refer Appendix 1 – Company and Group Structure

ACM employs nine staff in Singapore and three in Tawau, Sabah. It works closely with its buying agent in Indonesia.

Refer Appendix 2 – ACM Pte Ltd Organisational Chart.

2.0 BUDGETING PROCESS

The financial year of the Group runs from 1st April to 30th March each year and budgets for the coming year must be approved before the start of the new financial year by the respective division's Executive Committee (ExCo). As such deadlines are very strictly adhered to.

2.1 BUDGETING PROCEDURES

A Budget package made up of budget instructions, diskette and timetable is typically distributed at the end of December. Company budgets are to be submitted to the head office (Corporate Control) within 3 weeks of receipt of package. Corporate Control would prepare a consolidated Divisional Budget for submission and review to the Budget Committee. The Budget Committee is made up of the senior management of the division i.e. the Divisional Finance Director, Group Accountants, Treasurer and Financial Controllers from the 3 trading centres. Upon completion of the review, the Divisional Budget would be submitted to the ExCo for approval. The ExCo is represented from the top management of the Group i.e. the Group Managing Director, Group Financial Controllers, and Divisional Board Members.

Refer Appendix 3 – Budget TimeTable

As there is a very short time allocated for submission of the company budget, the preparation of budgets is done earlier.

Following is the comparison of ACM's budget procedures with the standard.

STANDARD

ACTUAL

Pre – Planning

1. Economic evaluation of Industry trends.
2. Analysis of Company's past performance, potential.
3. Establishment & publication of objectives and policies.
4. Development of summary operating & capital investment plans.
5. Review & publication.

Steps 1 – 5 are usually carried out in October/November. These activities are scheduled by Corporate Control from head office. Each business unit in the Group has to submit a five-year plan and an Annual Operating Plan. The Budget is a translation of the Annual Operating Plan in financial terms.

In order to arrive at these strategic plans, a review of the company's performance in relation to its objectives, likely outcome in the near and medium term are discussed.

Possible business scenarios are discussed and the operating plans are based on the most likely scenario. A SWOT analysis, customers and competitors analysis, including a financial review of year – to date performance and forecast for the

current year are included in the Annual Operating Plans. These plans are documented and submitted to Corporate Control for their consolidation.

An important input towards the company's formulation of plans and business strategies is the Group Conference. This is a week-end conference held annually for senior and middle managers in the Group to discuss issues, opportunities and problems that managers face in their business areas. It provides managers with the opportunity to have a macro-view of the Division's business and direction, interact with top management and give suggestions.

Budget Preparation

6. Preparation of Operating Programs for next year:

- (a) Sales
- (b) Inventory
- (c) Operating Costs and Expenses
- (d) Research

Under Step 6, the sales forecast is based on objectives set in the Annual Operating Plan. In ACM's case, the purchases form inventories and it has to match the sales volumes. As sales are done throughout the year whilst

purchases are seasonal due to the various crop patterns, the budget has to take into consideration the uneven inventory periods as this has serious impact on the financing, cash-flow requirements and warehousing capacities.

A review of operating costs and expenses is done on the warehousing operations, logistics and office administration. This is undertaken by the trading and administration departments.

Research activities are carried out at Group level and each unit is required to contribute towards its expenses.

7. Preparation of financial programs

- (a) Cash Flow,
- (b) Capital Investments
- (c) Financing Requirements (Short term, long term)

Step 7 is prepared by the company's Financial Controller based on inputs from the trading and administration departments as well as programs set in the Annual Operating Plan.

ACM's funding is from the Group Treasury. Accurate sales and purchases forecast and the anticipated price levels are very important for budgeting financing requirements.

8. Translation into Operating and Financial Budgets.

Steps 8 and 9 are prepared simultaneously by the company's Financial Controller. These are prepared according to the standard format of the budget package.

9. Consolidation into Operating and Financial Summaries in Management Reporting Format.

10. Management review of financial consequences of operating and financial programs.

Steps 10 and 11 are usually done by the Managing Director and the Financial Controller. Other managers are only consulted if there is a major need for revision of assumptions and forecasts.

11. Adjustments of Program to improve projected results.

12. Corresponding adjustments of Budget Summaries.

Steps 12 and 13 are the responsibility of the Financial Controller.

13. Final approval and publication.

Control of Operations

14. Preparation of regular reports comparing performance with Budget.

15. Review and explanation of Variances.

16. Corrective action and revision in Budget, if necessary.

Steps 14 to 16 are done on a periodic monthly basis. Budgets are prepared on a monthly basis, and performance reports are submitted to Corporate Control on same basis for comparisons. In addition to the monthly review, quarterly reviews are also done.

2.2 MERITS AND DEMERITS

Being part of a large and well-established group of companies, the budgeting procedure at ACM is well documented and structured. The company views the budget as a planning and control tool. In order to view its effectiveness, the merits and demerits of the procedure in relation to the management functions of the company are looked at.

2.2.1 Planning

This stage of the budget process is well handled. Since the pre-planning stage is treated separately in advance of the budget process, management is not under time pressure. Sufficient thought process and creativity is allowed in the formulation of the company's strategies. The Group Conference is a very useful aspect of the pre-planning stage as feedback from attending managers has been very positive.

The three alternative scenarios of the business environment – ranging from very negative to very positive and most likely, makes top management aware of the range of possible events. This would help them evaluate management's strength and ability to "read" the signals in the environment. By being aware of the negative and positive outlooks, management is better prepared to act quickly to minimise the risk or to take advantage of the opportunities when there is an unexpected change in the situation. Top management will not be biased on the outcome, as they would be aware of the change in circumstances. This is important for effective evaluation and control.

The forecasting techniques used for the budget are very simple. Since the company has to abide by Group guidelines, there is little room for

negotiation. The Group expects a return on capital in excess of 25 percent and looks for a market share of 25 – 30 % generally. As the company serves industrial customers it is relatively easy as the customers are all known to the company and would be aware of their purchasing requirements. Since cocoa prices are difficult to forecast (and immaterial as the company uses hedging methods to protect margins), the company's targets are based on volume i.e. tonnage and trading margin per metric ton.

2.2.2 Control

Being a large corporation the Group uses the budget as a control mechanism. Consequently, this characteristic is practised in all Group companies. Monthly performance reviews is the first stage to check for variances and the reasons for the differences. Budget revisions, although subject to controversy, are allowed provided circumstances justify.

2.2.3 Motivation

A possible shortcoming of the company's budget is that it does not help to motivate employees very much. According to Barrett and Fraser (1977), in order to motivate, employees should be given objectives that are difficult yet attainable.

The company does not depend very much on budgets as a motivation tool. This is in order to remove the possibility of managers "padding" budgets to reflect better than target performances on their part. The Group's philosophy is one of running a "tight ship". Since top management is involved in daily trading functions, they are aware of what is happening at

‘ground level’. Thus any “buffers” put in the budget are likely to be noticed and taken out. Objectives set are high and managers are rewarded to meet these objectives. Managers are aware that just as it is important to meet objectives, it is equally important to inform top management when budgeted objectives will not be met. By being alerted early, top management will have advance warning and will have the opportunity to take corrective action. As the parent company is a public company, the Group is very conscious of disclosure and compliance rules. It prefers to have its performance to at least meet its budgeted objectives.

Despite this, employees (especially junior employees) still tend to regard the budget as management’s tool to measure their performance. Another complication arises when bonuses are given out. Although a bonus pool is set for in the budget, the final outcome depends on the companies and Group performance. Although the budget is not used to motivate and bonuses are not contractual, employees perception of what is fair invariably contradicts management’s opinion as the amount of bonuses paid out are moderated by the Group’s overall performance. Problem arises when the company performs better than the parent company.

2.2.4 Communication

The company obtains good participation at the planning stage. At the preparation stage junior management are required to give inputs. However once budgets are finalised and approved, there is little downward communication to the staff except for their relevant areas only. During the course of the year, staff is kept informed of the company’s progress but in very vague tones e.g. “ We are doing O.K.”. Sometimes employees (junior managers especially) are not even told that the budget has been formally

approved by the ExCo. They have to assume that what was put forward has been forwarded. Such oversight by the management may seem trivial but can affect the staff morale leading to reduced commitment and motivation. For these employees, the budgets will end up as being a management exercise only.

2.3 RECOMMENDATIONS

A budget that is good for planning purposes will not be motivating enough as managers will tend to just meet targets. In ACM's case the company will have to separate the company's performance with the Group performance if it wants to motivate employees to do better. There have been several attempts by the company to do so and it looks like this year it will prevail.

The company will also have to improve its downward communication. Since it is still a small organisation (by staff strength), and team work is regarded as a corporate virtue, it is important that the company communicate to its managers and junior managers that have participated in the budget planning and preparation stage, the companies progress in more concrete terms, whether it is better or worse than targets. This would make the team more cohesive and the company would get greater commitment from the staff.

3.0 CONCLUSION

From the study, it can be concluded that the company practices a good budgeting procedure. A lot of effort has gone into the planning stage. The budget packages are standardised with improvements being incorporated each year to make it more user-friendly and to better serve management needs. Companies are encouraged to give alternative scenarios and free flowing commentaries. The time period has been kept quite short, 3 weeks for submission to the Budget Committee. This forces managers to be focussed and disciplined in their work. Overall on the technical aspects the company has a good system.

However on the softer issues relating to the human side of management functions, the company has not been able to maximise the budget's utilisation as a management tool very effectively. Although there is better participation at planning stage, activities at the preparation stage are centralised around the Finance Department and there is little feedback to the other participants once the budget has been accepted. Over time, this lack of communication could lead to a negative impact on the company as staff morale is lowered especially when the number of employees increase.