Generic Management

Learner Guide

Module 4 – Management & Controlling Skills

FETC Generic Management – Level 4 - SAQA ID: 57712 LP 74630

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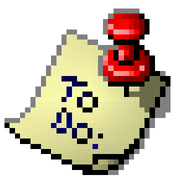
Key to Icons used in this book

We have used symbols (also called icons) throughout the text in this module which can help you quickly identify what you need to do. Here is an example of what each one will require you to do:

Activity



This icon indicates that you are required to complete certain activities that will assist you with your studies.

NB / Note well

This icon indicates information of particular importance.

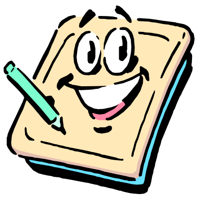
Definition

This icon indicates a clarification of a word/concept or the nature of something.

Portfolio

This icon indicates an activity that can form part of evidence for assessment.

Self Evaluation



If you answer the self-evaluation questions indicated by this icon, you will be able to assess the degree of success you have achieved in mastering the study material.

This module comprises of the following unit standards:

SAQA ID	Unit Standard Title	Level	Credits
242829	Monitor the level of service to a range of customers	4	5
242810	Manage expenditure against a budget	4	6

When you have completed this manual you will be able to:

- Identify internal and external customers, where applicable.
- Explain standards of customer service expected by the organisation.
- Measure customer satisfaction on an ongoing basis.
- Recommend corrective action
- Explain the concept of budgeting pertinent to an area of responsibility.
- Determine the elements of a budget relevant to an area of responsibility.
- Monitor and control actual expenses (and revenue), against projected budget

NOTES

Unit Standard: 242829
Monitor the level of service to a range of customers

When you have completed this section, you will be able to understand and explain the following:

- Identify internal and external customers, where applicable.
- Explain standards of customer service expected by the organisation.
- Measure customer satisfaction on an ongoing basis.
- Recommend corrective action

From the moment customers walk in your door, your workplace is communicating with them. Let's see what messages they may be receiving.

Message 1: Communication about the organisation comes from visual and other sources

The first communication is non-verbal. The customer gets a general message from the layout of the organisation and its colours, signs, noises, aromas and 'atmosphere'. Ideally the message is one of welcome and the customer feels welcome and pleased to be there.

Message 2: The body language of staff

Further communication takes place as the customer spends longer in the organisation. Staff speaks in body language long before they speak in words. Ideally their body language says they are waiting to help. Sometimes they communicate that the last thing they want to be bothered with is a customer. Or they might look so happy talking to each other that the customer doesn't want to interrupt the party. Their clothes and personal presentations express a lot too. A strong impression of the organisation is created in the customer's mind.

Message 3: The verbal message

Finally the customer talks to a staff member. The staff member's verbal skills, both speaking and listening, are now needed.

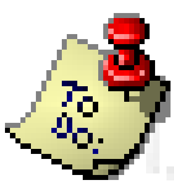
Specific Outcome 1:
Identifying internal and external customers

WHO IS MY CUSTOMER?

In the Introduction, the term 'customer' was used in its usual meaning of a person shopping in a store. However, there is a wider meaning used in modern business organisations: Your 'customer' is any person at work who uses your services. We can divide them into two groups: **external customers** and **internal customers.**

External customers are those who do not belong to your workplace. They are outsiders who use your services: shoppers, trades people called into your workplace who need information or assistance from you, people making enquiries, and so on .

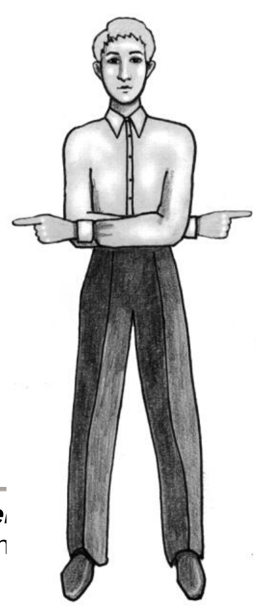
Internal customers are fellow employees who need your services. They might be your supervisor, manager, workmate or any other employee.



Activity 1: My customers

Here is a picture of you in the centre of this box (draw more details of yourself if you like). List all your external and internal customers in the labelled areas. You can either write their names and/or the jobs they do.

My External Customers



Customer Value

Once you have customers you need to ask the following questions:

- How do we identify our customers?
- How do we plan to retain them in the future?
- How do we intend to develop them in the future?

When looking at customer profiles set against relative satisfaction and perceived value once can identify two main categories that must be managed.

High Satisfaction/High Perceived Value

These are customers who would make excellent advocates for the organization. They need to be nurtured and given special treatment.

Low Satisfaction/Low Perceived Value

These are customers who can be classified as saboteurs as they will have little or no loyalty and may actively 'evangelize' against the organization.

NOTES

Specific Outcome 2:
Standards of customer service expected by the organisation

Why Do We Need Customers?

It might seem like an obvious statement but let's put this into a logical format.

Customers have needs and wants → these create demand → Demand generates orders → Orders generate production → Production allows supply → Supply satisfies demand → Customers pay for this satisfaction

The Basic line is that without customers there is no money and without money there is no business!

Unfortunately in many organizations the linkage between customers and money is not well established the deeper into the organization one travels.

What Do Customers Want?

Quite simply

- Customers want to have their needs satisfied.
- Customers therefore want our products or services to deliver benefits to them.

The benefits received are what our products or service can do for the customer.

It is important to remember that the same feature of our product or service may deliver different benefits to different customers. As a result the impact of the same product/service may vary dependent on the customer.

Customer Expectations

Rule No 1

You cannot assume that you know what a customer's expectations are. You must ask.

Rule No 2

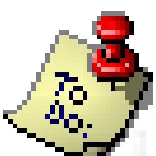
Customer expectations will constantly change so they must be determined on an on-going basis. Customer expectations for the same product or service will vary according to:

- Social and demographic factors
- Economic situation
- Educational standards
- Competitor products
- Experience

There is always a need to ask - Do customers do business with you because you meet their expectations on:

- Quality?
- Price?
- Product?
- Location?
- Customer Service?

But an equally important question is to ask what will keep them as your customer?



Activity 2: Why do your customers currently do business with you? Why will they continue to do so? Please provide as much detail as required.

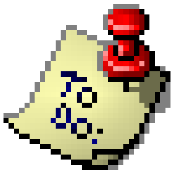
NOTES

Communicating with your customers

Keep these points in mind while communicating with customers:

Clear and accurate
Open, not judging
Mind customers' feelings
Mention their names
Unlearn your own poor habits
Non-verbal messages matter
Interest in people
Calm if they're angry
Ask questions, get feedback
Try liking people and (most important!)
Enjoy working with them.

Specific Outcome 3:
Measuring customer satisfaction on an on-going basis



Activity 3: Reflecting on experience as a customer

"Do as you would be done by" is a good guiding principle. It is also a quick way to learn about Customer Service. If you like to be treated in certain ways when you are a customer yourself, it stands to reason that these are exactly the ways to treat your own customers at work.

Think of the service you have received in various organisations lately. Make a list of things the best staff members do or say which contributes to very good service.

Specific Outcome 4:
Recommending corrective action

Activity 4: Making customers more welcome

Let's get your ideas. If you could, how would you improve the way your workplace communicates with its customers?

If you have a lot of good ideas, do this on your own. Otherwise, ask some other people (your coach/trainer, colleagues) for their ideas as well.

Make notes under the headings given below.

Improving in-house communications

Visual Improvements (company layout, signs, colour schemes, written messages):

Improvements in staff body language:

Improvements in staff's verbal communications:

Activity 5: Speaking to Customers

Below are some statements made by a retail company's staff to customers. In the column beside each statement, give it a rating.

The rating scale is:

Rating	Description
A	Top quality communication, the sort that brings the customer back again.
B	Average. No one could object, but no one would call it good service either.
C	Awful. This could lose a customer.

Statement to Customer	Rating
1. 'No I won't refund money on those football shorts. They've got grass stains on the back and beer stains on the front. Some people!'	☐
2. 'I don't know where it would be'.	☐
3. 'Sorry, we don't have moose hats in this department. But the millinery department might be able to help you. They're on the second floor. The nearest stairs are just over there on the right'.	☐
4. 'I only speak English'.	☐
5. 'I wouldn't buy that. It makes you look like a whale'.	☐
6. 'Don't be so pushy. He was here before you'.	☐
7. 'Yeah, I agree with you about this place. At least you don't have to work here'.	☐
8. 'I am sorry you aren't happy with the service. I understand your point and I'll see my manager about it straight away. If you leave me your name and phone number, I'll get back to you this afternoon and let you know what action the store is going to take'.	☐
9. 'I don't know how the product works. Sorry'.	☐
10.'Well hullo there. Where have you been all my life?'	☐

Rewrite and improve these 3 statements

1. **‘**No I won’t refund money on those football shorts. They’ve got grass stains on the back and beer stains on the front. Some people!’

Improvement:

2. ‘Don’t be so pushy. He was here before you’

Improvement:

Formative Assessment Activity 1
Please open your Portfolio of evidence (Logbook) and complete the activities for this specific outcome, following the instructions found in your logbook.

Your facilitator will advise you as to the requirements and deadlines for completing and handing in these formative assessments. Write these instructions here:

Unit Standard 4: 242810
Manage expenditure against a budget

When you have completed this section, you will be able to understand and explain the following:

- Explain the concept of budgeting pertinent to an area of responsibility.
- Determine the elements of a budget relevant to an area of responsibility.
- Monitor and control actual expenses (and revenue), against projected budget

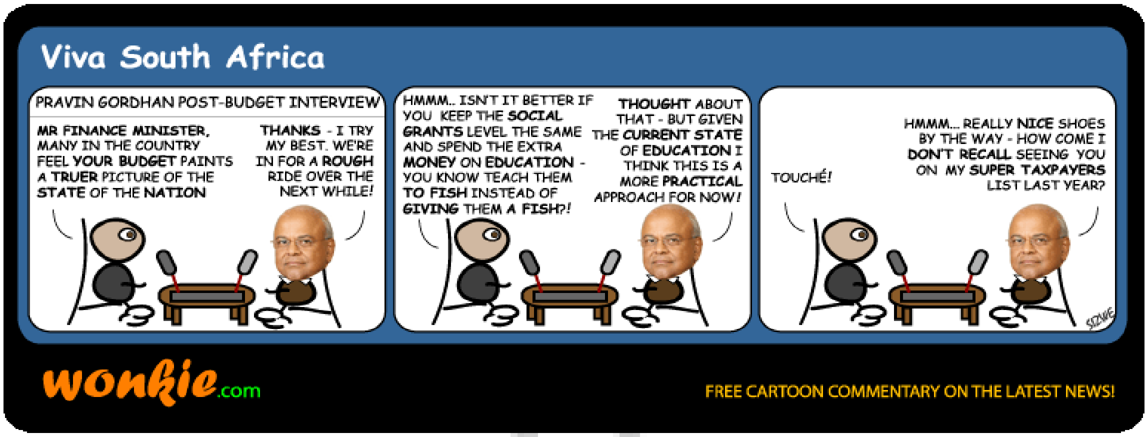
Introduction
The business environment has become increasingly conscious about their costs, thus it important that the income and expenditure in organisations is controlled. The basis for the control comes in the form of a budgeting process, which defines the business operations for the coming year. The budget can determine the success of the business for the near future.

Although budgeting is very important in organisations, often management with little expertise and experience in budgeting are required to define the budget. Sometimes they also have restricted understanding of what the business is possible of achieving. Many organisations prepare their budget once a year, as it is a time-consuming task.

Financial planning is crucial to any business. This course focuses on applying the budget function in a business unit. When a company develops beyond a certain size, then it needs to divide itself into separate business units, cost centres or departments. This will make it easier to manage the company as a whole. Each strategic business unit (SBU) then needs a definition of its business which specifies the area in which it competes. A business unit is therefore a company within a larger company. A company can define its businesses in terms of the products they manufacture, or the customers they serve.

For the purposes of this course, a business unit also includes a small business.
This course focuses on using and understanding budgeting as a planning tool for a business unit within a larger company. In Learning Unit one, the concept of budgeting is highlighted. The income and expenditure for a business unit will also be discussed in more detail in Learning Unit one. Learning Unit two focuses on analysing the budget needs of a business unit. Various techniques and implications of budget elements will be discussed in more detail.

Presenting a proposed budget for a business unit will be discussed in Learning Unit three. It is always important to monitor and control the actual expenses and revenues in any business. This will be discussed in more detail in Learning Unit four.



Specific Outcome 1:
Explain the concept of budgeting pertinent to an area of responsibility

A budget is nothing more than a breakdown and plan of how much money you have coming in and where it goes. Could you imagine a business becoming successful if it didn't keep track of its income and expenses? The same holds true when it comes to your personal finances. If you don't know how much money you have coming in and where it goes, your road to financial success will be a difficult one.

Every person uses a budget to control activities. A person can budget time or funds. A budget can therefore be defined as:

> **"A written statement of the organisation's goals and forecasts in financial terms for a specified future period"**

The budgeting process is the continuous planning to ensure that the organisation has enough funds available to successfully run the business. A budget is therefore a financial plan for the future. The business needs to plan for future activities and management needs to decide how to finance these activities. A budget is also used to control the various activities such as the income and expenses.

A budget for a business unit therefore describes the financial plan for a small business, or for a department or a cost centre within a larger organisation. In this unit, the term budget refers to planning for the income and expenses of a typical business unit.

For any business to plan successfully, it needs to develop short – term and long – term goals. Short term goals are usually developed for a period not exceeding one year. Long – term goals are usually developed for a period of three to five years. It is important that management develop the long – term goals first and then the short – term goals. Short – term goals can only successfully be implemented if management has a comprehensive knowledge of all the operation's functions and expenses. Because detailed information about operating expenses is needed, it is essential to have a good **costing system**. A costing system is a breakdown of the business which shows where the money is being spent and how much is being spent.

By implementing a costing system, line managers can be held responsible for how much they are spending and any necessary adjustments to resources allocation can be made.

A **cost centre** is an area of an **organisation**, department or function, which incurs measurable costs in its operation. Cost centres deal with a specific type of cost called **overhead costs**. Overhead costs are those costs that cannot be assigned to a specific activity or item. They are costs that are spread out over a large area or function. An example of overhead costs is the rent of a building that is being shared by many different departments. The overhead costs are then linked to the cost centre in order to spread the expenses over all the areas where the cost is incurred.

When a manager develops a budget, he or she must also develop long – term and short – term financial goals. This will have already been formulated in the business plan.

A budget shows how management plans the organisation's finances. A manager needs to understand the basic expenses that the business incurs every month. The income received from the business and the expenses incurred by the business need to be reconciled. In order to do this, an income statement and balance sheet must be drawn up.

An income statement reflects the business's income minus it's expenses for a certain period of time, usually a month. A balance sheet on the other hand, shows the business's financial position at a specific point in time. It is like a snapshot and it shows the possessions of the business, known as **assets**, as well as the **liabilities** of the business.

It is important to understand the basic concepts of all the income and expenses when developing a budget.

- **Income / Revenue**

  Any source of money (revenue) received by the business is referred to as income. Example of income include the sale of goods and/or services, interest received, commission received, rent received and discount received.

- **Expenses / Expenditure**

  Expenses are needed to run the business. For example, every business has to pay its employees' salaries; it may have to pay rent for it's offices or premises. This will enable the business to operate on a daily basis. It is important to try and keep these expenses as low as possible. Other examples of expenses include interest paid, electricity and water, telephone bills and trading license.

- **A debtor**

When a customer purchases products from the business, does not pay the amount in full, it means that the customer is in debt and he or she (the customer) becomes a debtor.

- **A creditor**

When the business buys product or services from another business (a supplier, for example), but does not pay the amount in full, then the other business is a creditor. The business therefore owes the supplier money. This is usually reflected in the balance sheet.

- **Sales**

The term sales refers to the income that is generated from selling goods and/or services for money.

- **Purchases**

Any business needs to buy goods in order to manufacture or sell their own products or services. Purchases can be described as the stock or inventory.

- **Cost of Sales**

The price paid for goods and/or services when buying them for a supplier is called cost of sales. The mark-up added to this price is usually expressed as a percentage.

- **Profit**

Profit is the difference between income and costs. There are two types of profit: **gross profit** and **net profit**. Gross profit is the difference between the selling price and the cost of goods sold. Net profit is the gross profit plus other income, such as rent received, less expenses, such as salaries. The net profit belongs to the owner or owners of the business and it will result in an increase in owner's equity.

- **Assets**

  The assets of the business refer to the possessions of the business. There are two broad categories of assets: **fixes assets** and **current assets**. Fixd assets are assets that have a long lifespan and include items such as land and buildings, equipment and furniture. Current assets are assets that are needed to run the business and have a lifespan of up to one year. This includes debtors, cash in the bank and stock or inventory.

- **Liabilities**

  Liabilities refer to the debts that the business has to repay. Liabilities are also divided into two broad groups: long – term liabilities and current liabilities, Long – term liabilities cannot be settled in one year. This includes items such as long – term loans and debentures. Current liabilities must be settled within a year and include a bank overdraft and creditors.

- **Capital**

  Whenever a person starts a business, he or she needs to put money into the business. This is called capital. If the business expands and becomes more profitable, the capital will increase, because the profits are included. If the business runs at a loss, then the capital will decrease.

- **Drawings**

  The owner or owners of a business take money from the business. This means that they take some of the profits as their salaries or income. This will lead to a decrease in the amount of money the business owns. (The capital).

- **Owner's equity**

  Owner's equity refers to the capital of the business, plus the profits, minus the drawings. This refers to the owner's or owner's money in the business.

The budgeting process starts with planning. Once management have developed the goals and objectives of the department or company, then it is crucial to develop a financial plan in order to realise these goals and objectives. The budget is in essence the financial plan specifying what expenses will be inured and what income can be expected.

A typical organisation, such as a rental outlet, structures it's activities around various functions. They then form departments for each of these functions.

The organogram below illustrates how a typical retail outlet structures itself.

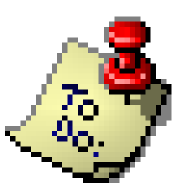
EXAMPLE

The example illustrates that the organisation follows a functional organisational structure whereby it organises its resources around the functions within the organisation. Each function is therefore a department, for example, the production department. Each department in turn needs to develop a budget, which forms part of the overall master budget.

The managers of each department would develop a budget for their own department, which is then incorporated into the master budget. The sales department would develop a sales budget and the production department would develop a production budget.

For example, a marketing manager for a large retail company must analyse the expenses of his or her department. The typical expenses for his department would include overhead costs, and indirect costs. The overhead costs refer to the costs of running the marketing department, and would include salaries and wages, a proportion of the companies rent, stationery, telephone costs, water and electricity, advertising and promotional costs.

The marketing department will develop a budget for each of its product. This will then be coordinated into one 'marketing department' budget. The 'marketing department' budget will then be reconciled into a master budget. A master budget combines all the budgets for a company.



Exercise 1
In your groups, discuss and list your budget for your department or area of work:

Income

Expenses

Direct	Indirect

Notes:

Specific Outcome 2:
Determine the elements of a budget in an area of responsibility

The purpose of the budget needs to be defined before the appropriate technique can be applied. There are three different budgeting techniques that can be used; these are incremental budgeting, zero-based budgeting and contingency budgeting. Other budgeting techniques that can be used are flexed budgeting and seasonally analysed budgeting.

Incremental budgeting (forecasting based on historic data) involves taking the costs incurred in the previous accounting period and adding other amounts to cover the increases of costs due to inflation and also to cover an increase in the business activity in the future.

It is important for any business to forecast the demand for it's products or services. This will indicate what the future revenue or income will be. When management has determined the income or revenue, then it can start to plan for the expenses.

A budget is usually determined on the basis of a financial forecast. A forecast is based on past information or data and trends. The relationship between the various items in a budget can also assist management in forecasting a budget.

Variables such as sales, stock, number of employees and demand require future forecast estimates so that managers can make important and effective business decisions. It is important to forecast or predict future income costs. This will enable management to make decisions necessary to maximise the income received and to minimise the total cost of the business.

There are, however, several quantitative techniques that can be employed to make accurate and reliable forecasts. The most important method is the time series analysis. The time series analysis is a series of observations that are taken at regular intervals in time, usually every quarter. The time series analysis uses data from past periods or quarters. The data is then examined to determine the long – term trends or movements. Management also looks for any patterns that occur often. Management therefore needs to analyse past budgets and expenses in order to forecast what they will be in the future.

The following example illustrates how to forecast an expense item.

Example:

Susan has realised that the advertising and promotional expenses has increased by 12% per year in the last three years. Last year she spent R10 000 on advertising and promotion. She has to forecast the new amount to be spent on advertising and promotion. R10 000 x $\frac{(100\% + 12\%)}{100}$ = R11 200 The amount to be spent on advertising next year is therefore R11 200

Example:

Joe needs to forecast what the sales and cost of sales and income will be next year. He estimates that the sales will increase by 30% and that the current expenses are expected to follow the latest trends. The other expenses will stay constant for the next year. The business did however take out a loan from the bank. This resulted in an increase in interest payments. The interest will increase to a fixed amount of R10 000 per month. All the other costs will remain in the same proportion to sales (therefore 30%). The total tax for the next year is estimated to be 30%. Given the following two income statements, forecast an income statement for the next year.

The following is the income statement for the last two years:

	Last year – R	This year - R
Sales	630 000	700 000
Cost of sales	(350 000)	(375 000)
Gross profit	280 000	325 000
Current expenses	(105 000)	(120 000)
Current income	175 000	205 000
Interest paid	(8 500)	(9 000)
Other income	6 500	6 500
Income before tax	173 000	202 500
Tax	(60 000)	(75 000)
Net income	113 000	127 500

The forecasted budget will look as follows:

	Forecasted budget – R	Explanation
Sales	910 000	30% increase
Cost of sales	(487 500)	53,5% of sales (375/700
Gross profit	422 500	325 000
Current expenses	(137 100)	*14,28% trend
Current income	285 400	
Interest paid	(10 000)	Given
Other income	6 500	Remains the same

Income before tax Tax Net income	281 900 (84 600) 197 300	30% tax x R281 900 (rounded off)

In order to calculate the trend in expenses, the following calculation needs to be made:

- Current expenses increased by R15 000 (R120 000 – R105 000). In order to determine the trend, the difference needs to be divided by the current expenses. This will indicate by how many current expenses increased.

$$\frac{R15\,000}{R105\,000} \times \frac{100}{1} = 14{,}28\%$$

$$R120\,000 \times 1{,}1428 = R137\,142{,}85$$
$$= R137\,100$$

Zero-based budgeting - As its name suggests, the budgeting starts by assuming that there is a zero or nil base. Keeping zero-based budgeting in mind, each item that is purchased can be analysed whether it was necessary and investigations can be made about how the goods can be obtained in the most effective way. This is a difficult and time-consuming task the first time that it is done, but following this the task is easier as the base has been made.

Example:

Thabo is in charge of a small retail outlet, called Fish Dish, in the South of Johannesburg. The head office is situated in Durban. His main objective for Fish Dish is to increase the overall profits by 150% in the next year. He has analysed the market and think that it is possible to increase his income if he advertises more in his area. He estimates that the advertising costs would amount to R24 000. He also decides to increase his production to make more sales. He therefore needs to expand his facilities, which would cost him R18 000. Depreciation is calculated using the straight line method at 20%. He decides that he will finance these alterations with long - term loan. He plans on paying half of the loan back (50%) during the first year. This should be possible if he withdraws all the surplus ash, on condition that the business maintains a favourable bank balance of R8 500 for ash flow purposes and the outstanding amount due to creditors does not exceed R30 000.

	Actual (R)	Budgeted (R)	Criteria and norms
Income	80 000	160 000	The objective is to increase sales 100% (R80 000 x 200/100)

Less expenses	65 300	126 795	
Deprec. Existing furn & equipment.	3 100	3 100	No charge
Deprec. New furn & equip.		3 600	R18 000 for new facilities x 20%
Delivery expenses	2 300	2 530	10% expected increase
Purchases	21 000	42 000	100% increase
Rent	12 500	12 500	No change in rent
Salaries and	9 500	16 625	75% increase
wages	5 200	5 720	10% expected increase
Water & Electricity	3 200	3 520	10% expected increase
Telephone	7 500	11 250	50% expected increase
Stationery	1 000	1 100	10% expected increase
Bank charges		24 000	New cost
Advertisements		850	New cost
Interest on loan			
Net profit	14 700	33 205	

Calculating expenses:

- **Income**: In order to calculate income, use the following formula:

Income = units x selling price
= 10 000 units x R8 per unit
= R80 000

Thabo would like to increase sales by 200%. It is already 100% so he plans to increase it by 100%.

- **Depreciation**: In the example, Thabo expanded his facilities with R18 000. This means that he has to calculate the depreciation of 20 % every year.

Straight – line depreciation means that the business deducts the same amount every year. R18 000 x 20% = R3 600

Depreciation is the amount by which an asset decreases in value as a result of wear and tear.

- **Delivery expenses**: In the above example the delivery expense increased by 10%

Delivery expenses = R2 300 x 110/100
= R2 530

- **Purchases**: In order to increase the sales by 100%, the business needs to purchase materials to make more products. This means that the purchases will also increase by 100%.

R21 000 x 200/100 = R42 500

- **Rent**: There is no charge in rent. The business pays the same amount of rent every year.

- **Salaries and wages**: The salaries and wages have increased by 75%.

R9 500 x 175/100 = R16 625

- **Water and electricity**: It is expected that the water and electricity will increase by 10%.

R5 200 x 110/100 = R5 720

- **Telephone**: The telephone and telecom services are expected to increase by 10%.

R3 200 x 110/100 = R3 520

- **Stationery**: A 50% increase is expected in stationery.

R7 500 x 150/100 = R11 250

- **Bank Charges**: It is expected that the bank charges will increase by 10%.

R1 000 x 110/100 = R1 100

Contingency budgeting allows for compensation for additional unknown events occurring. The size of the total budget and the activities of the organisation determine the size of this allowance.

The nature of the organisation determines the budgeting technique that is used. For example a business that is seasonal, for example selling beach slops and swimming costumes will make use of a seasonally analysed budget. A business that wants to take additional control over their expenditure would probably use the zero-based budgeting technique.

This ensures that only items that are really necessary are purchased and that the business is operating using a value-for-money approach. The incremental based budgeting allows for unnecessary expenditure and those in control of the budget know that the allowance will increase the following year.

Organisations that are in different financial positions are required to choose the budgeting technique that will suit them. For example, a business that is planning and trying to expand, will probably use incremental budgeting, but a business that is being careful with their spending will use zero-based budgeting.

Contingency budgeting is used by businesses that there is a great possibility that other unforeseen expenses will be incurred. For example, an estate agent may use contingency budgeting when a property of house is for sale at a price that is below market. They will be able to purchase this investment a good price and sell it for a much higher price. Seasonal analysis applies to businesses that sell seasonal goods and services.

Elements of a Budget

Businesses determine their business plans and according to this the budget needs are determined. For example, consider a hotel that is planning to expand the number of rooms in the hotel has certain needs. They will have to build the additional rooms, ensure that the staff is able to cope with the extra work, that the electricity supply is still sufficient and that the restaurant and bar can cope with the additional guests. The hotels financial needs have to be updated and considerations for additional buildings and other staff hiring must be included into the budget. Budgeting needs can differ from year to year, depending on the organisations current needs.

A budget needs to be developed according to the economic viability of the organisation. A budget that is developed that is too high, will result in too much money being spent on expenses. The financial position and the expense of management needs to be determined before the budget can be defined accurately.

When it is time for the budgeting process to really begin, there are some steps that must be taken. For example, a budget journal needs to be made. This is a way of ensuring that many people are involved in determining the items that make up the costs in a business. Following this, all the different costs of the business need to be understood. The items that need to be placed in a table format are:

- Income
- Direct costs

- Indirect costs
- Capital costs
- Fixed costs
- Variable costs
- Capital

Values and actual numbers for each of these can be determined, through using past budgets, information gathered through doing some research on budgeting and by gaining access to the invoices and vouchers from which the accounts were developed. The past budgets for the business are used frequently, as this forms the basis of the budget without having to do too much additional research or work.

A budget breakdown is prepared for a business when the activities are planned and can be accommodated for. This can only be done after the necessary information has been collected. The following values for the budget are determined and the costs for these are estimated:

- Total income
- The direct costs of producing goods and services
- The costs of the overheads
- The amount of money spent on capital equipment

The budget breakdown items should then be substantiated and justified. The reasons for the values and the way in which these are calculated need to be shown. Management should be satisfied with the predicted income and expenditures, making the budget breakdown a necessity. It is important that these figures are substantiated, especially in the future when the budget is reviewed. The proposed activities should be assessed according to the cost benefit returns. This means that the cost of the activity and the benefit that the activity provides must be compared. There is little point in performing activities, functions and services that cost a lot of money and provide only a small amount of return. The return for the cost of the activities needs to be high for the activity to prove viable.

After this has been done, the future operations can be predicted. By having sound knowledge of the occurrences of the previous year, the following year can be predicted based on previous information. Questions that need to be answered are what the expected income is, whether it is more or less than last year and whether the products and services will be higher in price due to inflation or any other reason.

In addition to this the proposed budget needs to be justified according to some research that has been performed, rational projections and from past experience. For example the budget can be developed based on new market research, projections about the market and also from records that the business has kept on past performance.

Following this, the budget can be prepared by either increasing or decreasing the previous year's budget by using the new information. The budget should end up being accurate and useful for the following year. Using an effective control system should monitor the budget effectively.

Remember the zero-based budgeting begins with the assumption of a nil base. This means that every expenditure is analysed and it is decided whether it is really necessary and investigations are made to determine the most cost-effective way of obtaining the purchase. The task of checking each purchase is a time-consuming task but improves with time. Once the database is determined, the budget is easier to manage.

There is a slightly easier way of applying zero-based budgeting, for example you would take the previous year's costs as the base and decide whether these costs are too high and whether savings can be made. When using this method, increases in prices due to inflation should be taken into consideration. This should be done item-by-item rather than by the overall percentage increase. Investigations should only be done where the potential saving is more than the costs of doing the investigations. Zero-based budgeting prevents the creation of additional money for other unforeseen expenditures. Sometimes expenses that you may not have thought about are incurred.

When budgeting, it is important that the income and expenditure timeframes are considered. This means that the terms of payment need to be analysed and planned for. It the hotel industry, many of them requires that guests pay their bills in cash, by credit or debit card or cheque. This means that the timeframe for receiving the money due to the hotel is immediate. Their expenditure in terms of paying their suppliers for the goods received can be negotiated and only paid over 30, 60 or 90 days. This means that hotels can order and receive goods without physically paying for the products. They can even do this without having the money in the bank; provided they are given a timeframe within they need to pay their accounts.

It is possible for businesses such as hotels to estimate and guess the amount of occupancy for each month. They can determine that they will probably be fully booked during the holiday season. This means that they are able to predict and forecast the amount of income and expenditure for each time period.

A budget is restricted by both internal and external constraints. For example internal constraints are factors such as the amount of capital that the business has that can be spent and the amount of projected income and sales. Basically a budget is restricted by the available resources that the business has. External factors in the business environment consist of factors such as the size of the market and unpredictable changes. A business operating in a small market with a large budget will probably fail to survive as the size of the budget is not suitable. Also a business may forecast that inflation would be at 10% but due to political instability the inflation rate rose to 16%. This is an unplanned and unpredictable change.

Internal and External Constraints

A budget is restricted or influenced by both internal and external constraints. Basically a budget is restricted by the available resources that the business has.

No one can spend unlimited funds on activities. These activities need to be carefully planned. From the planned activities, a budget is drawn up. There can be certain constraints when developing the budget. Internal constraints on a budget included can be the result of the planned activities and available resources within the business. Management usually have control over the internal factors, but not over the external environment. For example internal constraints are factors such as the amount of capital that the business has that can be spent and the amount of projected income and sales.

The objective of the overall company can have an influence on the budget. If the objectives state the business needs to increase productivity and decrease costs drastically, then it would be difficult to develop a budget which reflects growth and expansion. One's department's budget also needs to coincide with another department's budget. Another internal constraint is the contribution of the owner's capital. As a business grows and expands, it needs more capital. The owners cannot always provide capital, which limit the amount of funds available to the business. All the activities cannot be implemented.

External factors that can have an influence on a budget included factors such as the market size and unpredictable changes within the business environment. A business operating in a small market with a large budget will probably fail to survive as the size of the budget is not suitable. Also a business may forecast that inflation would be at 10% but due to political instability the inflation rate rose to 16%. This is an unplanned and unpredictable change.

For example, a manager develops a budget, and he or she estimates that the income for sales would be X amount. If the market is not large enough, or there is no demand for the product because of unpredictable changes, then the sales would not be realised and the manager would have to alter his or her budget drastically.

Unpredictable changes include variables in the economic, political and legal environment, socio-cultural, technological, competitive, and international environment. Suppliers may even decide that they are going to increase their pries. This will increase the expenses of the budget.

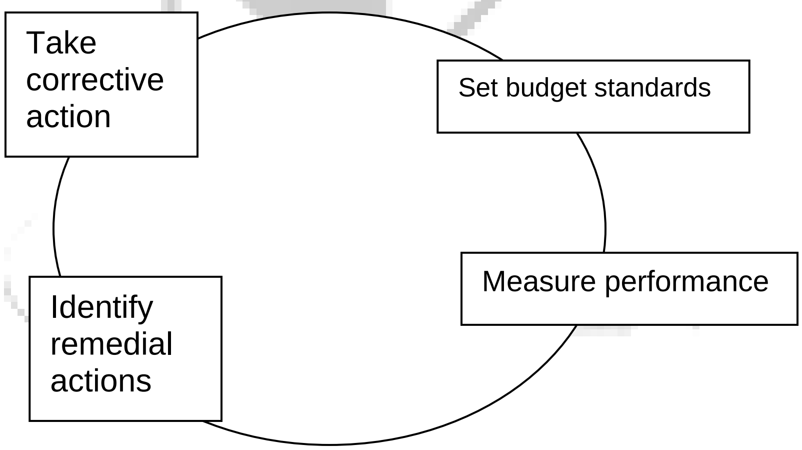
Management should try and predict the likelihood of occurrence for any variables that can have an influence of the budget.

NOTES:

Specific Outcome 3:
Monitor and control actual expenses against budget

Once the budget has been defined by a business, it is essential that the income and expenditure is monitored and controlled. Effective monitoring is done at regular intervals and accurate comparisons are made between what was planned for and what actually happened. This can be done by implementing a budgetary control process. This is a very easy process to keep control of and it is very effective especially when budgets have been "seasonalised" to show the income and expenditure for the different times of the year. This is especially important for businesses that sell and produce products and services that are seasonal, for example surf shops, ice-cream sellers, sun screen producers, sheep skin slipper manufacturers etc.

The budgetary control technique is illustrated and explained below.



Budgets are known as the blue-prints for businesses and it is essential that they are 'managed' and controlled effectively. This ensures that the projected level of income is reached and that the projected expenditure is not exceeded.

It is important that these budgets are controlled well, as the process of developing a budget is a long and time-consuming and would be wasted if it is not monitored.

1. Setting standards or objectives – these are implemented when the budget is calculated and agreed upon.

2. Measuring performance against budgets – when performing this part of the process, the actual budget figures are checked against the budget projections.
3. Identifying areas for action – the areas where there is a great difference in the budget and the actual performance, these need to be worked on.
4. Taking corrective action – this requires that the necessary action is taken so that the budget is brought back into line and is being maintained according to the proposed budget.

This budgetary process is a continual process and is performed at the end of the period that the budget has been set for. This can be at the end of each year, each month or whatever period has been specified.

When ensuring that budgetary items are recorded correctly and accurately, the following must be ensured:

- The managers responsibility in terms of the budget need to be defined
- The manager must take an active part in developing the budget, by preparing and originating the budget
- Management also needs to be committed to control and regular reports need to be made so that budgets are maintained
- All actual expenditure and income must be recorded accurately, reliably and quickly
- Abnormalities in the recorded budgets needs to be investigated as soon as they are detected
- When unexpected factors are experienced, budgets should be able to be amended quickly to show the changes

Gross Revenue

Gross revenue refers to the income received by the business. The income of a business therefore consists of the receipts from the sale of the business's products or services**.**

Income = Units sold x unit price

There are also other sources of income, such as interest earned on investments. Gross revenue, however, refers only to the income from the selling price x the sales quantity.

Example:

A business sells 200 products at R10 each and 50 products at R20 each. Calculate the gross revenue.

Gross revenue = Selling price x quantity
= R10 x 200
= <u>R2 000</u>

Gross revenue = 50 x R20
= R1 000
The gross revenue is therefore R3 000 (R2 000 + R1 000)

In order to calculate the gross profit, the manager needs to calculate the cost of goods sold. This means the amount of money that it costs the business to make the sales.

The total income must be forecasted in order to develop a budget. After determining the income, can the manager start to look at the costs. If a department or unit wants to increase the sales, it needs to increase the costs as well. The department needs to purchase more products or raw materials in order to sell more products and increase their income. This will lead to the cost of sales, which means the cost incurred to generate more sales. Developing a sales budget is discussed at the end of this unit.

It is important to understand the following terms:

- **Gross revenue**

Gross revenue refers to the income of the business. It includes the selling price per unit x the sales quantity.

- **The net revenue**

The net revenue refers to the gross sales less any returns and cash discounts.

- **The gross profit**

The gross profit refers to the difference between the net revenue and the cost of goods sold. It is therefore the difference between the cost of goods sold and the selling price of the goods.

Profit is the difference between income and expenses. As noted earlier, there are basically two types of profits. Gross revenue or profit is the positive difference between the cost of goods sold and the selling price. Net profit consists of the gross profit plus other income less expenses. The net profit belongs to the owners of the business.

If the difference is negative, then the business will result in a loss.

When the expenses exceed the costs, it is a loss. This will reduce the owner's equity and increase the risk of failure.

Expenditure in a Business Budget

Any business needs to incur expenses to run a business. The following list shows the typical expenses and income for a small consultancy firm.

Advertising and promotion	Leasing charges
Bad debts	Legal fees
Bank charges	Levies
Cleaning	Motor vehicle – petrol and oil
Computer expenses	Motor vehicle – repair and maintenance
Consulting fees	Motor vehicle – insurance, license
Consumables	Printing
Courier and postage	Rent paid
Discounts allowed	Repairs and maintenance
Donations and gifts	Salaries and wages
Electricity and water	Staff training
Entertainment	Staff welfare
Financial charges	Stationery
General expenses	Subscriptions
Insurance	Telephone and fax
Interest paid	Travel and accommodation

These costs can be grouped together. Management needs to understand the various types of costs when developing a budget.

The total cost of a product equals the fixed costs plus the variable costs. The following costs need to be identified:

- **Overhead costs**

Overhead costs are those costs that are unavoidable in any business.

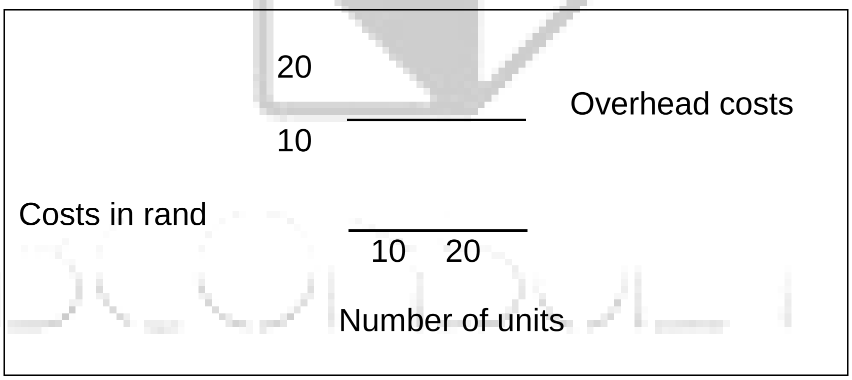
These are the costs that must be incurred to rub the business. An example of an overhead cost is rent. A business needs to pay rent for business premises in order to conduct business. Another example is salaries and wages. Employees who work for the organisation need to be paid. Other examples include promotional and advertising expenses, insurance premiums and fees to local municipalities.

Overhead costs are indirect costs. The reason for this is that they cannot be related directly to the manufacturing of a product. The business cannot state that rent is directly related to the manufacturing of one particular product. Overhead costs are also referred to as fixed costs, indirect costs or operational costs.

- **Fixed costs**

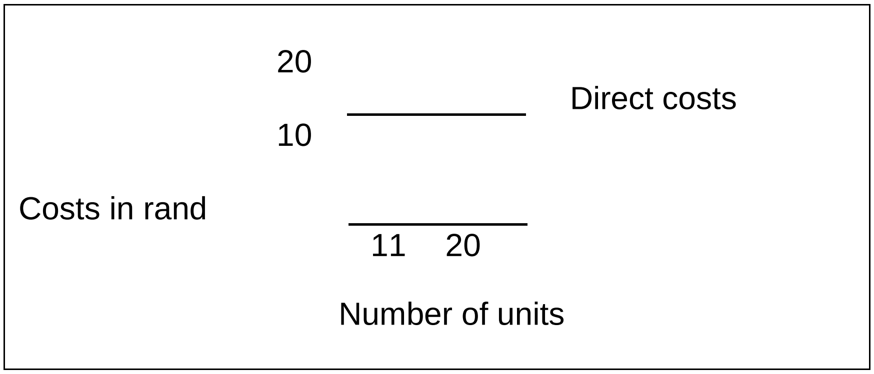
The fixed cost is the portion of the total costs that remains the same during the manufacturing of a service. Example of fixed costs includes office rent, depreciation on equipment or vehicles and salaries. If the entrepreneur manufactures more products or units, the fixed costs will stay the same. He or she still needs to pay rent and salaries, even if he or she does not produce more products. Fixed costs will remain unchanged, even if production increases or decreases.

The following graph illustrates the fixed costs.



- **Direct costs**

Direct costs are also called variable costs or cost of sales. They are called direct costs because they are expenses incurred to acquire or manufacture a single product or service. Direct costs are directly related to the volume of sales. If the sales increase, the direct costs will also increase. The direct cost is therefore the portion of the total costs that change according to the volume of production. It includes material costs. For example, if the business sells chocolate, then the business man or woman needs to buy sugar, flour etc. to make the chocolate. The direct costs vary with the increase or decrease in production. The following graph illustrates the direct cost per unit.



The accumulated direct costs are called the cost of sales.

Profit is the favourable difference between income and expenses. A loss is the result when the cost exceeds the income.

The gross profit is illustrated in the following example:

EXAMPLE

Budgeted Income Statement of ABC for January 2010

Sales	R20 000
Less: Cost of sales	(R10 000)
Opening inventory R8 000	
Materials R6 000	
Labour R3 000	
Less: closing inventory (R7 000)	
Gross profit (revenue)	R10 000

The opening inventory is the inventory that is left over from last month. In this example, the business had R8 000 worth of stock or inventory left from the previous month. This has not yet been sold. The materials refer to the purchases of materials the business made during the month. The business may have ordered and bought raw materials from a supplier in order to manufacture more products. The labour costs of R3 000 refer to the cost of making the specific products or delivering a service. The closing inventory refers to the stock that the company has left in it's storeroom at the end of the month.

The following formula can be used to calculate the cost of goods.

Opening stock
+ Purchases
- Closing stock

= Cost of goods sold

The department or unit cannot keep on purchasing stock or inventory. It needs to control its ash flow. This means that the business needs to plan so that it has enough cash to pay for the inventory so that it can generate more sales.

Cash management is very important in any business. If a business does not have enough cash, it would not be able to pay its monthly expenses. The cash cycle explains the importance of cash flow within the business.

Cash — Raw materials — Finished products — Customer — Cash
The business needs cash to buy new materials. It then needs to transform these raw materials into finished products. These products are then sold to customers, which generate income. The customers often pay on credit, which means that they pay the purchase price off over a certain number of months. Only several months after the customers have bought the products, will the business receive the cash. The cash needed to buy the materials is called the cash outflows (cash payments). The cash received from the customers is called the cash inflows (cash revenues).

The cash cycle also shows that there are lag times between buying raw materials and receiving money from the customer. These lag times can cause cash – flow problems. Management therefore needs to develop a cash budget to plan for these lag times. A cash budget is a formal plan for forecasting future receipts and payments of cash. This means that management must forecast what the sales are going to be in the future. An estimate of the monthly cash flows can be determined after estimating the projected sales.

It is necessary in any business, to make cash payments. Examples of cash payments include cash purchases, payments for creditors and rent or lease payments. When customers pay cash for a product, it forms part of cash inflows. But in some cases, a customer may buy on edit. This means that he or she does not pay the full selling price immediately, but instead pays it off over a period of six or perhaps nine months. This means that the entrepreneur only receives these ash payments in bits every month. The manager therefore needs to forecast accurately how much cash he or she is going to need to run the business.

Cash will be flowing in because of sales, but cash will also be flowing out because of stock purchases.

The format of a Cash Budget is illustrated below:

	Jan	Feb	Mar	April	May	June
Cash receipts						
Less Cash payments						
Net Cash flow						
Plus: Beginning cash						
Ending cash						

Each of the items in the cash budget will be explained in more detail.

- **Cash receipts**

Cash receipts come from cash sales, collections from creditors, interest received, etc. This is the money that flows into the business.

- **Cash payments**

Any cash paid for operating expenses, raw materials or other purchases are cash payments. These are all the expenses such as rent payments, insurance, salaries and wages, interest payments, loan repayments and tax payments.

- **Net Cash flow**

The difference between the cash receipts (cash inflows) and cash payments (cash outflows) is the net cash flow.

- **Beginning cash**

The cash balance has been brought forward from the previous month is the beginning cash.

- **Ending cash**

The ending cash is the cash that the business has after all the expenses have been paid. This includes the beginning cash plus the net cash flow.

The cash flows are the expenses that are necessary to run the business. If the business does not have enough cash to pat it's monthly expenses, it an lead to cash flow problems. Cash flow problems can influence the business's long – term position in terms of liquidity and solvency.

The liquidity of a business has nothing to do with profitability. Liquidity refers to the ability of the business to pay its short – term expenses regularly and on time. If the business lacks cash, it will not be able to pay its expenses. If a business has a healthy liquidity position, it means that the business has enough cash to pay its monthly expenses.

Budget Variances

One of the most important aspects in financial planning is to record all the activities as accurately as possible. This will enable management to identify any deviations or differences between the planned and the actual results. If there are any differences between the planned and actual results, then it will be illustrated in a **variance report**. This report will indicate the variance and a manager can detect any trends. A manger can take corrective action if there is a significant difference between the planned and actual results. New budgets can then be developed. Most managers should use past experience and conduct research in order to make changes to the existing budget.

It is important for every business to record all its activities. This means that the manager must keep track of any changes that may occur. In order to detect any mistakes that may be made, a manager needs to evaluate the budgets. Evaluation involves comparing the actual results with the budgeted figures. The difference between the actual figures and the budgeted figures is called a **variance.** During evaluation of the actual and budgeted figures a manager can determine and investigate any serious variances. He or she can then make further decisions to ensure that the planned results are achieved or to change the initial planning in the light of the current situation.

Larger, more established, companies usually have a very good control system and can detect changes quickly. A person (or group of people) responsible for the budgeting process is (are) also responsible for controlling its financial implications.

Variance reports are reports that reflect the difference between what has actually happened and what the budget predicts will happen. The report ensures that the necessary corrective action is taken to make sure that the budget reverts to the planned direction. Variance reports ensure that the budget is maintained and that the final objectives are reached. There are three main steps in variance analysis, these are checking the actual results against the projected targets, identifying what the variance is between the two and finally to analyse the reasons why there was a variance.

The variance report forms part of the feedback function in budgets. The feedback is information that is acquired through assessing the difference between what actually happened and what was supposed to happen. After this information has been received, actions can be taken to correct the differences. These corrections may be chosen by using past trends.

It has already been discussed that past trends are important in determining the budget, but this information can also be used to project future activities and to make changes to the current budget. This information should be recorded and stored for future use when projecting future activities and making changes to existing budgets.

Control Systems

The control systems that are used in businesses are used so that they can monitor and control the revenue and expenses of the business. Basically to ensure that the actual expected income is reached and so that the projected expenditure is not exceeded. An effective control system, as illustrated and explained above consists of setting the budget standards and objectives, measuring performance against the budget standards, identifying the areas for corrective action and finally taking the action to correct the variances.

A variance serves as a means of identifying problem areas, which must receive corrective action. Correction action must be taken as soon as possible.

- If the variance is favourable, it is indicated with a '+' sign and if the variance is unfavourable, it is indicated with a '-'sign.
- If the actual income is higher than the budgeted amount, then it is a good thing. More income was received than the business for. But if the actual income is less than the business planned for, then the variance is unfavourable.
- If any of the actual expenses is higher than the budgeted expenses, the variance is unfavourable. This means that the manager should take corrective action to address the problem. If the actual expenses are lower than the budgeted expenses, then it is a good thing because the business has kept the costs lower than expected. The variance would also be favourable.
- The net income would be unfavourable if both the income and the expense variances are negative or unfavourable.
- If the units (actual amount of products0 are taken into consideration, then the budget will reveal more information than the example.

An example of an income statement, showing the actual and budgeted results, as well as the variances is illustrated:

EXAMPLE	Actual budgeted amount	Estimated amount (Rand)	Variance
Income	163 500	165 000	+ 1 500
Less expenses	(123 690)	(123 300)	- 390
Depreciation: existing equipment	1 900	1 900	0
Depreciation: new equipment	2 240	2 500	+ 260
Delivery expenses	2 800	2 700	- 100
Purchases	40 000	41 000	- 1 000
Rent	13 000	13 000	- 0
Wages	22 500	21 000	+ 1 500
Water & Electricity	6 000	5 900	+ 100
Telephone services	7 500	7 200	+ 300
Bank charges	1 300	1 350	- 50
Advertisement	16 000	16 500	- 500
Interest on loan	1 450	1 550	+ 100
Stationery	9 000	8 700	- 300
Net profit	**39 810**	**41 700**	+ 1890

This income statement shows that the net profit has increased with R1890, and that the overall expenses decreased with R390. A small saving therefore resulted in a higher profit.

The following balance sheet also shows the actual and the budgeted figures.

EXAMPLE	Actual budgeted amount	Estimated amount (Rand)	Variance
OWNER'S EQUITY			
Capital	32 160	35 100	+ 1 000
Balance from the previous year	22 500	22 500	
Add profit for the period	11 900	15 600	-3 700
Less drawings	2 240	3 000	+ 760
LIABILITIES	**22 500**	26 000	- 3 500
Long – term liabilities			
Loan from the bank	15 000	17 000	- 2 000
Current liabilities	7 500	9 000	- 1 500
Creditors	7 500		
	54 660	**61 100**	**-6 440**

ASSETS			
Fixed assets	**31 500**	**30 500**	
Furniture and equipment	31 500	30 500	+ 1 500
At cost	35 000	33 500	+ 1 500
Less depreciation	3500	3 000	- 500
Current assets	23 160	30 600	
Debtors	16 000	19 500	- 7 440
Cash in bank	7 610	11 100	- 3 500
	54 660	61 100	- 3 490
			- 6 440

When analysing the balance sheet, it is clear that the business's current assets have increased, which means that the business has increased the amount of working capital needed. Liabilities have also increased, which means that the business now owes more. Corrective action must be taken and these problems need to be addressed.

The balance sheet will also reflect the variances, but the business manager cannot state that the business variance is favourable or unfavourable. The business may have spent money on acquiring fixed assets, which can be very beneficial in the future. It is therefore not unfavourable, even if the variance is negative.

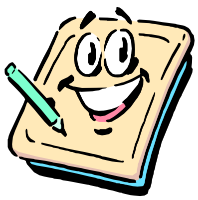
The business manager must therefore find out why there is a variance in the budgeted figure.

Notes:

Formative Assessment Activity 2
Please open your Portfolio of evidence (Logbook) and complete the activities for this specific outcome, following the instructions found in your logbook.

Your facilitator will advise you as to the requirements and deadlines for completing and handing in these formative assessments. Write these instructions here:

Self-Evaluation



Complete the following Self-Evaluation to see if you are ready to start the next module:

Standard / Legend:

Above average Competence	5
Competence – Meet the standard	4
Almost there	3
Not quite there yet	2
Still need to improve in this area	1

By the end of this module I feel that I can do the following:

Identify internal and external customers, where applicable.	
Explain standards of customer service expected by the organisation.	
Measure customer satisfaction on an ongoing basis.	
Recommend corrective action	
Explain the concept of budgeting pertinent to an area of responsibility.	
Determine the elements of a budget relevant to an area of responsibility.	
Monitor and control actual expenses (and revenue), against projected budget	

What I would have liked to spend more time on:

Annexure: No 1
Training Evaluation

Please complete this form and tear it out and leave it on your facilitator's desk before leaving the course on the last day.

Your honest and helpful opinions will only contribute to making this course even better in the future. Thank you for taking the time to be with us on this **Management & Controlling Skills Programme**.

Ratings:

1	Poor
2	Areas for Improvement
3	Meet the standard requirements
4	Very Good
5	Excellent

Was the facilitator: ………………………Tick where appropriate	1	2	3	4	5
Prepared for the training					
Knowledgeable of the subject matter?					
Able to handle all the questions posed by the delegates?					
Able to interact with the delegates?					
Voice clarity of the facilitator?					
Able to use the training aids (flip charts, hand-outs, etc.) effectively?					
Dis the facilitator make the training exciting?					
Would you recommend the facilitator for future training?					

Other comments on the facilitator's delivery of this training:
