



KD TRAINING SOLUTIONS

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Chartered Management Institute



Diploma in Management and Leadership

Resource Management
Unit 5004



Candidate Self-Study Guide

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THE DIPLOMA IN MANAGEMENT AND LEADERSHIP

Welcome to The Chartered Management Institute Diploma in Management and Leadership that has been specifically designed to meet your needs whether you are a first line manager, new middle manager, thinking of working in such a role or looking to expand your management potential and business knowledge. It provides you with an excellent opportunity to network with other managers and become more effective in self-development, managing information, people, operations and resources.

Before you start work on the programme, please make sure that you read this introduction thoroughly so that you fully understand what you have to do to be successful.

This qualification was revised on 1 September 2008 and consists of the following core and optional units:

Core Units:

- 5001 – Personal development as a manager and leader
- 5002 – Information based decision making
- 5003 – Performance management
- 5004 – Resource management
- 5005 – Meeting stakeholder and quality needs
- 5006 – Conducting a management project

Optional Units:

- 5008 – Marketing planning
- 5009 – Project development and control
- 5010 – Human resource development

For the purpose of your Diploma in Management and Leadership, you will be studying the 5 mandatory units (plus 5006 – an integrated project) and 5008, 5009 and 5010.

Each Unit is presented to you in a separate candidate self-study guide and should be used in conjunction with the monthly workshops and personal research.

This guide contains some basic information, followed by some questions and it should take you between 10-30 hours to work your way through, depending on the topic and whether or not you attend the relevant workshop. If you make some notes against the questions and add this to your research which you will have the relevant knowledge to complete your work. The total time required will also depend on your experience and should become less as you progress through your programme.

The dates that you are required to hand in your work are clearly marked on your programme so please make sure you become familiar with them and make every effort to stick to them. Essentially, you will be required to bring one completed piece of work to each monthly workshop (unless it is the project workshop) and if you do have problems, however small, please do not hesitate to contact us.

Having completed all core units and 3 optional units to the appropriate National Occupational Standard you will be awarded the Diploma in Management and Leadership.

RESOURCE MANAGEMENT - UNIT 5004

Unit Overview

This unit is about identifying, planning, using and evaluating resources to meet objectives.

Level

5

QCA Unit Number

J/501/5036

Credit Value

7

Learning Outcomes

Each topic has a set of learning outcomes that you will be able to achieve by the time you have worked your way through this self-study guide. Attended the relevant workshop and carried out some research. At the end of this Unit, you will have the knowledge and understanding of how to:

1. Identify and plan resources needed to meet objectives
2. Select and use the resource supply chain to meet planned objectives
3. Monitor and evaluate internal and external resource use to meet plans

Unit Contents

This Unit contains 4 parts:

Part A –

Part E – Unit Summary

MANAGING FINANCIAL AND NON-FINANCIAL RESOURCES (C42)

This Unit contained 4 parts:

- Part A – The Nature of Resources
- Part B – Sourcing Suppliers
- Part C – Financial Planning
- Part D – Financial Forecasting
- Part E – Unit Summary
- Part F – What's Next?

Introduction

According to Weaver M (1998), an organisation is a collection of people, things and systems which work together towards a common set of objectives and in order to achieve those objectives, the various parts of the organisation must have individual objectives and these need to be controlled in order to ensure a successful outcome.

If an organisation is to operate properly it needs both non-financial and financial resources to do this.

This self-study guide focuses on the key elements of planning and controlling non-financial and financial resources and will include:

- The nature of resources and how they are required to allow you to implement your plans
- Sourcing suppliers (both external and internal) and solving supplier problems
- Financial planning through the use of budgets
- Financial forecasting through the use of financial and non-financial considerations

At the end of this guide, you will have learnt about managing both financial and non-financial resources and how this contributes the performance of an organisation.

PART A – THE NATURE OF RESOURCES

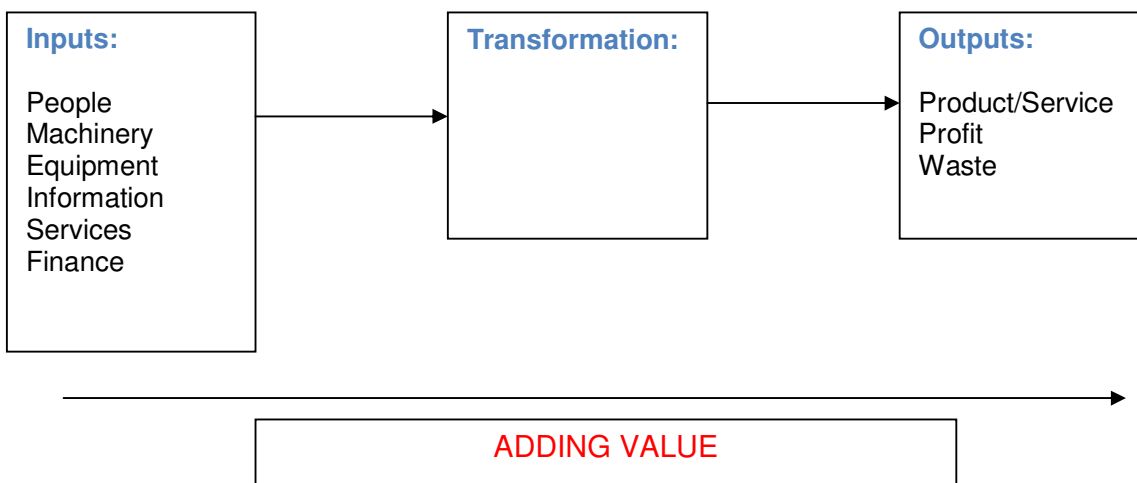
Objectives:

At the end of Part A you will be able to:

- See your organisation as a transformation process where inputs are turned into outputs that the customers requires
- Describe how the different levels of planning are planned and implemented
- Describe the many benefits of strategic planning
- Explain the strategic planning process
- State the 4 goals of functional or operational plans
- Produce a functional or operational plan
- Describe what affects resource demand in your organisation and explain how resource requirements are calculated

Introduction

Depending on where you are on your Diploma programme, you may well have heard many times that an organisation is often seen as a transformation process in which “inputs” are taken and “transformed” into “outputs”. This is illustrated below:



This transformation process takes many forms and could be:

- Moving an object from one place to another (transport services)
- Making a project (manufacturing)
- Adding to a project (trading or storage services)
- Providing an experience (cinema)
- Educating (education services)
- Keeping safe (police services)
- Processing (administrative services)

What are the inputs and outputs of your organisation and what is the type of transformation process?

Organisational planning

Before your organisation can consider exactly what resources it requires, it must plan for future activities. Basically, there are 3 levels of plan which are outlined below:

- Strategic planning
- Business planning
- Operational planning

In simple terms, strategic planning determines where your organisation is going over the next year or more, how it's going to get there and how it'll know if it got there or not. The focus of a strategic plan is usually on the entire organisation, while the focus of business and operational plans is usually on a particular product, service or activity.

There are many benefits to strategic planning, such as:

- Clearly defining the purpose of your organisation and to establish realistic goals and objectives consistent with that mission in a defined time frame within its capacity for implementation
- Communicating those goals and objectives to the organisation's people
- Developing a sense of ownership of the plan
- Ensuring the most effective use is made of your organisation's resources by focusing them on the key priorities
- Providing a base from which progress can be measured and establish a mechanism for informed change when needs
- Getting the best out of everyone in your organisation
- Producing more efficient and effective work
- Bridging staff and managers
- Building strong teams

The strategic planning process involves:

- **Defining the mission and objectives** - the mission is the guiding statement that an organisation will be working towards and the objectives are actions that will allow it to work towards its mission
- **Environmental scanning** – enables the organisation to identify its internal strengths and weaknesses, its external opportunities and threats (if you done previous units, you may recall that the external element consists of the Micro (or Task) and Macro (or General) environments
- **Strategy Formulation** – which is where internal strengths are matched to the opportunities in the external environment (whilst, of course, addressing internal weaknesses and external threats)
- **Strategy Implementation** – involves putting together programmes, budgets and procedures and utilises the organisations resources
- **Evaluation and Control** – is where the strategy must be monitored and changes made where necessary. Evaluation involves defining what is to be measured, measuring it, comparing the results with the desired result and making changes if necessary

What process does your organisation follow when developing its strategic plans?

The business plan answers the question “how are we going to achieve the strategic plan” and according to Jones G L (2000) is created by managers of each division in order to create long-term goals that will allow that division to meet the strategic objectives.

An operational or functional plan concerns functional managers and states the goals that are proposed to enable the pursuit of business level planning objectives.

Operational or functional planning

Having established the 3 levels of planning, let’s look in a little more detail at operational or functional planning. A plan can be short term, medium term or long term and basically states what will happen, when it will happen and who will be involved.

The purpose of a functional plan, according to Jones G L (2000) is to indicate how a function intends to achieve its goals. It is concerned with the actions of various managers in individual departments to add value to the organisations goods and services (as described in the transformation process above).

As a manager at this level you could:

- Lower the cost of creating value so that your organisation can keep its product/services more competitive
- Add value by finding other ways to differentiate it from other organisations

As a manager whose role is to add value in your area, you should consider the following objectives:

- **To attain superior efficiency** – which is about doing as little as possible and achieving as much as possible
- **To attain superior quality** – by providing goods or services that are of a high quality and are what your customers desire
- **To attain superior innovation** – through innovative ways of producing the goods or services and thus giving your organisation its “uniqueness”
- **To attain superior responsiveness to customers** – whether they are internal or external. Advantages are gained over other organisations or providers for companies who react faster to what their customers want

What are your overall objectives trying to achieve compared to those above?

Implementing plans

Having established the various types of plans, the process involved and what you should be trying to achieve at your own level, let’s now look at the process of implementing your strategy. It basically involves 4 things:

- **Setting SMART objectives:**
 - Specific – detailed comments on what is to be achieved
 - Measurable – measurements can be made to ensure success
 - Achievable – challenging but achievable
 - Realistic – the right resources are available
 - Timebound – setting a time limit
- **Detailing the plan** – by putting together a set of activities and allocating resources to groups or individuals
- **Implementing the plans** - by getting them going and monitoring/updating where necessary. After all "The best laid plans o'mice an' men/Gang aft a-gley." claimed 18th-century poet, Robert Burns. Translated “aft a-gley” means "gone astray."

- [Reviewing and evaluating the plan](#) - to make sure you achieved what you set out to achieve

When putting together your own operational or functional plans, how closely does the process match that explained above?

Identifying resource requirements

When you are detailing your plan, you need to decide what type of resources you need and in what quantity. The amount of resources you need might be affected by:

- Extra demand that might be caused by special promotions or new products/services
- Seasonal fluctuations (i.e. colleges and the traditional September enrolment date)
- Unexpected demand caused by people suddenly becoming aware of your product/service

As a manager you would be expected to gauge your need on:

- Your experience from the past
- Knowledge about certain events that you know require more resources than normal
- Statistical techniques (like averages)

What do you base your resource requirement on?

Involving your team in resource identification

In addition to using your own experience, there is no reason why you cannot use the experience of your team members as well. After all, they probably use most of the resources and can offer you sound advice.

Perhaps you should consider:

- Getting your team to record the resources they use
- Asking them to contribute to resource planning
- Agreeing that they should monitor what they use
- Discussing resource problems with your team

One way of developing ownership and responsibility in dealing with resources is to try and ensure your team members have what resources they need to carry out their job is to meet regularly to discuss usage and problems. It is at these meetings that you might discover trends and developments that might alter the amount and type of resource required.

Part A – Summary Quiz

Having completed Part A you should now be in a position to understand what information is all about and how it should be looked after. Try the quiz below and then re-visit this guide to make sure you have the right answers:

- What is the transformation model all about?
- What are the 3 normal levels of planning?
- What are the benefits to strategic planning?
- What process is involved in strategic planning?
- What are the 4 goals of functional/operational plans?
- What is the process involved in producing functional or operational plans?
- What sort of issues can adversely affect resource requirements?
- As a manager how can you gauge your resource needs?

PART B – SOURCING SUPPLIERS

Objectives:

At the end of Part B you will be able to:

- Describe the types of resources used by organisations
- Correctly identify suitable suppliers
- Explain what to consider when choosing between suppliers
- Improve the service provided by your internal suppliers
- Build up a good relationship with your suppliers and negotiate a formal service they are to provide
- Deal effectively with supplier problems
- Be aware of the contents of a suitable tender or contract

Introduction

Probably the first thing to identify is what a supplier actually. Well, it's someone or some organisation that supplies you with products or services that in turn, help you to provide your product or service to your customers.

A supplier is formally defined by www.lookwayup.com as “someone whose business is to supply a particular service or commodity”.

Why buy goods or services?

It is virtually impossible for any organisation to provide all of its own goods and services. For example, how would it supply electricity/gas or raw materials? There also seems to be some sensible reasons why goods and services are bought in and they are:

- To provide the raw materials necessary for a manufacturing or production process
- To run machines and equipment (i.e. electric, gas and water)
- To carry out specialist work that the organisation cannot do
- To employ people (such as Agency staff) when hiring full time staff would be inefficient from a cost point of view
- To carry out work faster or better than full time staff

Using the list above, make some notes about goods or services that your organisation buys in:

Identifying suppliers

Having identified the type of goods/services that you need to buy in, it is time for you to identify which supplier can best provide what you require. One of the first decisions you probably need to make is can your goods/services be provided by one supplier or should you have more than one.

There is the obvious advantage that you know who you are dealing with if you chose the single supplier option. You could also negotiate deals that you might not get with multi-suppliers. On the other hand, there is always the risk of you falling out with your supplier which means that you then have to change everything you currently do. It is up to you to weigh up the pros and cons and decide which the best option is.

Another issue you might want help with is how to choose between suppliers. You might want to consider some of the following factors:

- Flexibility
- Price
- Quality
- Reliability
- Lead time
- Customer service
- After sales service
- Delivery

Have a think about goods/services that are currently delivered to your organisation. Which of the above issues do you think influenced someone to choose them over other suppliers?

Internal suppliers

At the beginning of this Part, we mentioned that suppliers could be internal as well as external. In order to find out whether your internal suppliers are performing to the standard required, it would not be unusual to carry out an audit of them. Does this happen in your organisation? If it does not, how do you know that internal suppliers even know what they are supposed to be supplying, let alone to what level?

It is not difficult to understand that to have a good relationship with internal suppliers you need to speak to them. The better relationship you have with internal suppliers the more likely you are to get what your work area needs to meet its objectives. Have a look at the following questions and grade yourself:

- I discuss my supply needs with internal suppliers on a regular basis
- I pay regular visits to my internal suppliers and they regularly visit me
- I know the managers of my internal suppliers
- I know who to speak to if there is a supply problem
- I discuss ideas with my suppliers on how they might improve their services

If you score low in the above, then you need to do something about it!

Negotiating with suppliers

Once you have established relationships with your suppliers (external or internal) you can exchange information and formalise things. You might want to use the same set of questions mentioned above in identifying suppliers.

Once you have a formal agreement in place you can work together and amend practices as required. At least you will both have something you have both agreed and can work with. Other important issues when negotiating with suppliers are:

- Being ethical and basing the buyer/seller relationship on mutual trust and understanding and this involves things like not revealing details of other suppliers to the one you are negotiating with
- Not committing to a contract unless authorised to do so which may mean ensuring that buying staff have the appropriate experience and ability (for example highly technical products)
- Not being fooled by comments like “If I negotiated any lower I will be losing on this deal”. They may still break even which may be sufficient to break into a new market
- Meeting suppliers face to face as opposed to dealing with issues over the phone (also meeting with all potential suppliers and ensuring that those authorised to make the appropriate decisions are present and that you make a written record of any meeting)
- Not overlooking long-term issues for short-term gains and ensuring that you are always in a position to justify why a certain supplier was selected so you are being seen to be fair

Solving supplier problems

Here is an example of a supplier problem that was posted on the Internet recently:

“I have a few problems with a supplier. Basically, I encountered this company when I was doing initial research for expansion of the business. He owns a car leasing company and said he could supply us with cars at very good prices - this was an ideal opportunity as they were very competitive.

Things developed and I paid £1500 deposit to secure 3 cars. However, he has not delivered 2 months later but keeps in regular contact saying they will be here soon. He always seems to have an excuse but he calls numerous times every day. At no point has he simply lost contact - he always answers the phone and returns call promptly!

I wrote an agreement which he signed which basically outlined that he would supply us with cars. I have his home and business address, checked out his limited company on the web and all is above board. My concern is that I may have lost the cash as this has gone on too long - does anyone know my legal position? I have bank receipts from payments made and the agreement. I am getting really annoyed now and have considered going to his house personally”

The question is how well did this person identify and source his supplier? If he had used the questions above and agreed a formal contract, he may not be in the position he is now. If he had done it properly, he would also have a legal standing.

Some other problems that may come from suppliers is that they:

- Increase their prices without any warning
- Supply goods or services that are suddenly of an inferior quality
- Not deliver in the time agreed
- Fail to deliver because they cannot get the stock in the first place

These are common problems and failing to deliver, because lack of stock is fast becoming a typical excuse for internet shopping because they tend to wait for bulk orders before they order themselves.

What sort of problems have you experienced with suppliers (external or internal)?

Tenders and Contracts

If you are involved in a tendering or contract process you might want to be aware of the following:

- **Open Tendering** – which is basically open to all suppliers and normally advertised in the press or specialist journals inviting firms to submit competitive tenders; the most competitive tender would generally be accepted. In some situations the lowest bid will only be accepted providing the contractor is reputable, maybe having completed similar work successfully in the past. Some advantages of open tendering are maximum competition, obtaining the lowest price and seen to be fair whilst disadvantages include poor quality, lowest tendering may not be fully equipped to deal with the contract and contractors with good reputations may not even bother tendering because of the increased competition
- **Restricted or Single Stage Selective Tendering** – It is possible that an organisation may only decide certain suppliers to tender for a contract and this would be based on their reputation, size, any previous dealings, financial reputation or brand image. Contractors may be contacted with a preliminary enquiry form, which indicates that a list of suppliers is being drawn up and asks whether they would like to be included. The advantages of this type of

tendering are possible higher standards limited competition and reputable contractors can be chosen. The disadvantages are that there is less competition and that the contract may cost a much higher price

Steps in the Tendering Process

There tends to be a series of steps involved in the tendering process and they normally involve:

- The purchasing department preparing contract documents
- The tender (open or restricted) is advertised
- The draft tender is sent to potential supplier
- Suppliers submit their tender
- Each tender is evaluated
- The contract is awarded

Does your organisation put contracts out to tender or do they tender for contracts? What sort of tendering do they normally get involved in? What is the tendering process compared to that shown above?

Preparing Contracts

Although you may not be directly involved in preparing contracts, sometimes individuals departments are and research shows that many managers sign contracts that are not properly completed. As a guide you should ensure that the following issues at least are in any contract:

- The contracted price and payment terms
- Main terms and conditions
- What happens if the supplier does not do what the contract agrees
- How the supply process will work
- Some detail on the quality required
- How invoices will be prepared and dealt with
- Details of how a supplier will contact a contracting business immediately should anything go wrong

Part B – Summary Quiz

Having completed Part A you should now be in a position to understand what information is all about and how it should be looked after. Try the quiz below and then re-visit this guide to make sure you have the right answers:

- What are the advantages and disadvantages in choosing a single or multi-supplier service?
- What issues must be considered when choosing between suppliers?
- How could internal supplier services be improved?
- How can you ensure that you have a good relationship with both external and internal suppliers?
- What sort of supplier problems can occur?
- What are the main tendering processes?
- What are main contents of an effective contract?

PART C - FINANCIAL PLANNING

Objectives:

At the end of Part C you will be able to:

- Explain what a budget is and why it is used by organisations
- Describe the process your organisation uses to produce its budget
- Identify some weaknesses in the budgeting process and highlight some of the many benefits
- Describe the various types of budget and explain the time periods over which they are used
- Explain how to prepare and evaluate your own budget

Introduction

A budget is simply a plan that outlines your organisation's financial and operational goals and thus may be thought of as an action plan. Another definition is “a set of mutually consistent, interrelated business plans for an organisation, exhibiting quantified and feasible plans of action and forecasts of results, together with the premises on which those plans are based”

Planning a budget helps a business allocate resources, evaluate performance, and formulate plans. This basically means that it is a plan expressed in quantitative and money terms and can include some or all of income, expenditure and the capital to be employed. Moreover, a budget can be drawn up for an entire organisation, any segment of the organisation such as a department or for a one-off activity such as a project.

By definition, budgets have to be prepared in advance and for this reason they are often referred to in terms of them being part of a feed-forward system. Feedback, on the other hand, is a term frequently heard both in accounting and ordinary use. Feed-forward is a very important word when it comes to budgeting because it means looking at situations in advance, thinking about the impact and implications of things in advance, attempting to take control of situations in advance.

Let's first look at some key tips and the benefits you will gain from using a budget properly.

Some Key Tips on Budgets

Most people seem to think that budgets are set in concrete and must be followed religiously but here are some interesting tips:

- A budget is about delegating responsibility to managers for them to spend money to help the organisation achieve its objectives not just for the sake of spending
- A budget is not just about spending money, so when preparing one it is vital that the sales (or income) forecast is available before you start

- The actual figures will always be different from the budget because the budget is only a forecast and forecasts are inevitably wrong
- Budgets do not have a defined start and end and should be a continuous process

The Benefits of Budgeting

Many of us prepare personal budgets that look at our income, what we intend to spend and most importantly what we will have left!! Surprising then to find that many managers prepare simple life budgets but not for the complex places in which they work. Some benefits are:

- **Planning and co-ordination** – because it works within the framework of overall objectives to produce detailed operational plans and planning is the key to business success. Each department is required to co-ordinate its activities into the overall plan in the form of the Master Budget referred to earlier so forces managers to think of the relationship of their function with other functions or departments
- **Clarification of authority and responsibility** – The adoption of a budget authorises the plans contained within and gives a subordinate a clearly defined role with the authority to carry out the tasks assigned and when activities are not proceeding to plan, the variations are re-opened to a higher level
- **Communication** – Because the budgeting process should include all levels of management, it is an important avenue of communication between top and middle management regarding the firm's objectives and the practical problems of implementing these objectives and, when the budget is finalised, it communicates the agreed plans to all the staff involved
- **Control** – This aspect of budgeting is the most well known and is the aspects most frequently encountered by the ordinary staff member. The process of comparing actual results with planned results and reporting on the variations, which is the principle of budgetary control, sets a control framework, which helps expenditure to be kept within agreed limits

Peter Drucker suggests the following 7 key areas that a budget must satisfy if it is to be effective:

- **Economical** – Are the controls economical or do they take up masses of staff time to produce? Is there any way they could be made more economical?
- **Meaningful** – Do they give useful information that managers can act upon?
- **Appropriate** – Is the system appropriate or is there too much or too little detail?
- **Congruent** – Do all the pieces fit together or do they come in different pieces? Do some reports concern numbers whilst others refer to percentages etc?
- **Timely** – Is the information received on time?
- **Simple** – Can they be understood by the manager or are they complicated and complex?

- **Operational** – This is very similar to “timely”. If a report is required by the 10th of the month, does it arrive so that a manager can get on with their job?

Think about your own department and the information you receive. How does it match up to Druckers 7 key areas?

- **Motivation** – The involvement of lower and middle management with the preparation of budgets and the establishment of clear targets against which performance can be judged, have been found to be motivating factors

Some Possible Weaknesses in the Budgeting Process

Before we venture off into the world of budgets, it is important to note that budgets have their problems and the main one is that the “unspoken assumption” that proper targets will be set by the budget. Whether it involves sales, output or departmental expense budgets, the assumption is that they will be satisfactory but in practice this is not necessarily true.

The main problem is that the people responsible for setting the budgets are also those responsible for achieving them! Human beings are not going to set themselves targets which they believe they cannot reach; therefore, it is very easy to set budgets at a level which is not designed to produce the most out of the resources being used by the organisation.

As people are of the understanding that assessment is based on how close to the budget the actual performance is, they often put great effort into ensuring the figures match. Sales or production staff could also “slow down” when they realise their targets have been met and this may discourage initiative and give a false picture of how the business is or could be doing.

Unnecessary expenditure can result from the belief that if less than the budget is spent, next year's allocation will be reduced. This normally presents itself as a mad rush to spend unused money just before the budget period ends.

A properly prepared budget will help you:

- See if the organisation's strategy makes sense
- See if the business is likely to achieve its objectives because they have been turned into figures
- Highlight potential problems and thus estimate the sensitivity of forecast profits to errors
- Measure performance against a standard that has been set
- Make decisions if the actual spending varies from the planned budget

The budget period

Most budgets in organisations cover a 5-year period although some may necessitate a period as long as 10 years. It is quite normal for the first year to be planned in great detail and from the 2nd to the 5th year, less detail is included.

Budgets may also cover weeks and months as well as whole years. This is because income and expenditure does not flow consistently all year round and at some time during the year, a company may be in the red. By dividing the year into smaller chunks it is easier to evaluate how well the business performed compared to the forecasted budget.

Types of Budget

There are several types of budget but the main aim is to produce what is called a master budget for the whole organisation. Then you can break the master budget down into smaller sections such as:

- A sales budget that includes prices and estimated revenues
- The purchasing budget that defines the volume, prices and when purchases should take place
- The personnel budget that reflects the numbers of people, what salaries and wages they will receive and how much will be spent on recruitment and training
- Some organisations will have a research and development budget
- Most organisations will operate some kind of cash budget to forecast cash flow

The Budget Process

In order that the proposed budget works, it is important the process is both rigorous and methodical:

- Determine the principal budget factor (i.e. the area that affects the rest of the proposed budget – normally sales, although it could be cash, raw materials, Government funding, skilled labour, land or equipment – in other words anything that limits the activity of the whole organisation)
- Identify any factors that determine the expected sales levels for the coming period
- Put together the sales (or income) budget
- Ensure that responsibility for contributing to the budget is devolved to the lowest level. In most organisations budgets are often set by senior managers and others are not involved
- Each “mini-budget” should then be fed up to senior management (notice that the emphasis is on the budget being built up from the “bottom”)
- Senior managers will then approve the budget
- The final budget will be used as a control tool as mentioned above for the period it covers

Preparing a Budget

There are some basic steps to follow when preparing a budget:

- Make sure you have the latest data
- Write down the basic planning assumptions and business strategy
- Define the business plan for the period under budget
- Prepare budgets for each department
- Ensure that each budget is consistent with the others

When the budgets are ready for implementation it is important that you:

- Monitor it and provide the appropriate people with feedback based on any variations
- Take some action on those variances that are sufficient to cause any major problems and ignore those that do not (but still look at them)
- Consider the effects of the variances against the initial business plan and revise the budget if necessary

Now let's have a look in detail on how to produce a budget, starting with identifying the parameters:

- **Identifying the parameters** – You should start with identifying the strategic objectives that we discussed in Part A as this will help you know what you are trying to achieve. On the other hand, you may have been given specific targets for both income and expenditure. An example might be “to save 10% on administration costs in your department”. The next thing you need to consider is the “limiting factor” and this could be anything from:
 - The amount of sales
 - An amount of money that is available for investment
 - The capacity of your organisation
 - The knowledge, skills and abilities of staff
 - The availability of raw materials
 - Legal obligations

You then need to decide which type of budget would suit you best. You may decide on one that includes only costs, only expenses or both. There are a couple of approaches:

- **Incremental budgeting** – which is used by many organisations and involves looking at what happened last year and updating it for the forecasted year. The main advantage of this method is that it can be done very quickly provided you have the information regarding actual costs – the disadvantage is that it is not considered as rigorous as starting from scratch
- **Zero-based budgeting** – on the other hand starts from the beginning and includes things like deleting old issues and coming up with new, more innovative ideas. Each item in the budget has to be discussed and accepted before it is included

Find out which type of budget is used in your work area. If it is incremental, could there be any advantage in changing to a zero-based model?

- **Gathering information** – the second phase of your budget preparation involves gathering information regarding the amount of money coming in and what’s going out. If you are allocated a specific amount of money, then your first question to answer is simple. If you are required to generate your own money, this is commonly referred to as “revenue” and comes from pricing. When calculating what is going out, you might want to consider what costs you will have, for example, staff wages, training, premises, rent, heating, materials etc
- **Drawing up your budget** – The next step is to draw up your budget forecast and the best method to use is a computer spreadsheet. You probably need 4 columns which indicates the topic, the estimated cost, the actual cost and the variance (to be discussed later)
- **Presenting your budget forecast** – Before presenting your budget forecast you need to make sure that everything you have already done is accurate. For example, are you clear about your organisations strategy (or are you clear on the amount of money you have available or what your budget is based upon i.e. 10% savings), are your estimates on income and expenditure as accurate as they can be and have you considered any changes that might affect your budget?
- **Submitting your budget forecast** – You may be required to submit your budget to a budget committee. What you need to think about when presenting your budget is can you answer any questions that you are likely to be asked. In other words, can you justify your budget

Keeping financial Control

In this final section we shall look at how you need to keep control of your budget. One important issue is who can “sign-off” any purchases that are made? You may decide, as the budget holder that only you will sign-off purchases or you might devolve your budget to others to sign-off.

One important factor is that, as the budget holder, you monitor what is happening in the budget. Whatever system you choose it should be straightforward and regular. You will gain the information you need to monitor from your prepared budget. Remember that you probably have 4 columns – the topic area, the budgeted cost, the actual costs and the variance. It is here you will wish to monitor to ensure that the actual are as close to the budgeted costs as possible.

Analysing Variances

Having agreed that the point of monitoring your budget is to see whether it is going as planned, variances that occur must be investigated. It is beneficial to you to investigate variances no matter how small and whether they are “adverse” or “favourable”. Let’s look at what these terms mean:

- **Favourable** - meaning, for example, that actual sales are greater than budgeted sales or actual costs are less than budgeted costs OR
- **Adverse** – which could mean that actual sales are less than budgeted sales or actual costs are greater than budgeted costs

Usually senior management would be concerned with adverse variances but favourable variances may also need investigation in case short cuts have been taken to arrive at the apparent advantageous situation.

Because we have already discussed that different departments could be responsible for budgets it seems to be appropriate that we discuss who would actually be responsible for any adverse variances and these would tend to be:

- Purchasing Manager – direct materials
- Factory Manager – direct materials, direct wages, machine running costs
- Marketing Manager – advertising
- Human Resources Manager - staff

Unfortunately, some costs will be non-controllable (like rates that are apportioned, fuel costs charged against the transport manager's budget where oil shortages cause prices to soar and heating costs in a work area where the heating system is controlled centrally) and some may arise in the budget centre but the responsibility may lie elsewhere. For example, idle time in one department may be caused by the failure of another department to supply information or materials.

Evaluation

At the end of your budget period, it is important to look back and evaluate the accuracy of your forecast and the effectiveness of the way you monitored the whole process. If you get your budget wrong you might want to ask yourself:

- What was it that went wrong and could you have prevented it?
- How accurate was the information you gathered and could this be improved?
- How quickly were problems spotted and dealt with?

Part C – Summary Quiz

Having completed Part A you should now be in a position to understand what information is all about and how it should be looked after. Try the quiz below and then re-visit this guide to make sure you have the right answers:

- What is a budget?
- What is a budget designed for?
- What are the benefits to budgets?
- What are some of the weakness in the budgeting process?
- What are the different types of budget?
- What are the different styles of budgeting called?
- How are budgets normally broken down from a time point of view?
- What re the parameters to be considered when preparing a budget?
- Why is it important to analyse variances, whether favourable or adverse?
- What is the purpose of evaluating a budget at the end of its period?

PART D – FINANCIAL FORECASTING

Objectives:

At the end of Part C you will be able to:

- Explain how to effectively use several methods of financial forecasting
- Choose between capital projects based on sound financial forecasting
- Identify non-financial considerations when choosing project solutions

Introduction

In this final section we will turn our attention to being able to forecast in order to help decide how best to spend money. You will find some or all of the techniques described in this section useful, particularly if you are asked to plan and monitor a project.

According to MSN Encarta to forecast is to “suggest what will happen or “be an early sign of something: to be an advance indication of something that is likely or certain to happen” and although forecasting is often unreliable, it is better than not doing anything.

From an organisational point of view it might decide to invest money to grow what is already does (new products or increasing output of current products), maybe even to reduce it current costs (i.e. introduction of technology) or to safeguard its staff through new health and safety procedures (i.e. upgrading premises, machinery and equipment).

Forecasting Techniques

When making capital investment decisions they usually involve a trade off between a large outlay up front with returns coming over several months if not several years. The problems is how to judge if an investment of say £1M now yielding a return of £100,000 per year over the next 15 years represents a good deal. The 3 techniques we are going to look at are:

- The **payback** method is by far the simplest approach to compute and to understand and involves taking the number of years by which the capital outlay will be recouped given the anticipated additional income generated. As a formula the payback period = **capital cost / annual revenue**. In the case of competing projects, the one with the lower payback period would appear to be the best bet. If a company invested £500,000 in a project that generated £100,000 profit per year, then the payback would be 5 years. Another machine that cost £800,000 with the same profits would have a have a pay back of 8 years so the first project would seem the best option

- Unfortunately, because it is simple, the pay back technique does have shortcomings. For example it assumes that:
 - There might be profits after the payback period is over
 - Profit is only considered over the whole payback period
- The **discounted pay-back** technique is a variation of the payback method and recognises that money changes its value over a period of time. For example, £1000 will be worth different amounts in 2, 3 and 4 years time. If you had £1000 to invest for a year your calculation would be $£1000 \times 110 / 100$ which would equal £1100. Your profit would be £100. You can find out what % discount you need to use because they are printed in tables and you can also purchase software that does it automatically for you. Below is an example that shows a project discounted at 10%:

Number of Years	Cash Flow	PV factor	Present Value
0	-£20.000	1.000	-£20.000
1	£5000	0.909	£4545
2	£8000	0.826	£6608
3	£7000	0.751	£5257

Using the payback technique, this project would appear to pay for itself in 3 years, however, by using the discounted payback method the cash flow in 3 years will only be £16.410. This technique is more useful than the payback method because it takes into account the “present value” factor but still nothing about the cash flow after the 3 years is over.

The **accounting rate of return** (or return on investment) looks at the over income and expenditure of an entire project and the formula is **Rate of return % = average annual profit / capital outlay X 100**. An example is shown below:

	Project A	Project B
Capital investment	200.000	175.000
Total profit	60.000	72.000
Life years	5	4
Average annual profit	12.000	18.000

If we use the accounting rate of return for each project it would look like this:

Project A

$$12.000 / 200.000 \times 100$$

$$= 6\%$$

Project B

$$18.000 / 175.000 \times 100$$

$$= 10.3\%$$

This method suggests that Project B would be the best choice. The advantages of using this method are that it is reasonably easy to compute, the results are relatively easy to understand and it looks at the whole life of the project. This method, however, does not allow for things such as inflation.

Non-financial considerations

Most people think in terms of finance whenever you mention buying something. There are, of course, other issues that need to be considered and they are termed “non-financial”. If, for example, you were asked to introduce technology to a group of sales people, in addition to considering the financial implications, you might want to consider the following:

- What about the ability to move information around, especially as sales people might be on the move quite a lot?
- What if information is needed regarding products or services that cannot be carried around?
- What if they only spend a small portion of their time in the office?

In the case above I am sure you will see that there are non-financial considerations that need to be considered too. The result might be that you purchase laptop computers instead of work-based PC's.

Part D – Summary Quiz

Having completed Part A you should now be in a position to understand what information is all about and how it should be looked after. Try the quiz below and then re-visit this guide to make sure you have the right answers:

- Why would organisation decide to invest money?
- What are the 3 forecasting techniques in this guide and how do they work?
- What must be looked at as well as financial considerations?

PART E – UNIT SUMMARY

This Unit has been designed to give you some knowledge and understanding regarding both non-financial and financial resources and after completing this workbook and attending the relevant workshop you will be able to complete the assessment.

In this Unit we have looked at:

- The nature of resources and the wider perspective of obtaining resources
- The need to identify and monitor suitable suppliers, including resolving supplier problems
- The way in which a budget is compiled, presented, monitored and evaluated
- The process of producing financial forecasts the techniques that can be used

PART F – WHAT’S NEXT

You are now ready to have a go at the assessment for this Unit so you need to:

- Carry out some research in addition to that contained in your self study guide and gather more information for your work (don’t forget the new resources on the CMI website)
- Make sure you attend the relevant workshop
- Follow the link from your resources page on www.kdtraining.co.uk to the key documents you need to complete the assessment for this unit. There you will find your:
 - Self study guide (Unit 5004)
 - Work brief (Unit 5004)
 - Marking sheet (Unit 5004)
- You will find an example of this unit’s work on the website under the old heading of “Managing Financial and Non-Financial Resources (Unit C42)”. The structure and contents are mostly the same for Unit 5004

When you arrive at the next workshop you should bring with you:

- Your completed management report for this Unit
- A copy of your marking sheet (loosely attached to your report with the self assessment completed)
- A copy of your work brief (loosely attached to your report)

All 3 items should be handed to the tutor at the workshop and then they will normally be marked within 15 working days and you will receive a copy of your feedback by email.

At KD Training Solutions we adopt the policy that you will not “get things wrong”, you” may just not do them right at the time”. This means that If you do not reach the required standard, you will be given an opportunity (after guidance) to resubmit the bit that you did not quite get right.

Good Luck!