# Budgetary Control and Financial Performance of Small and Medium Sized Enterprises in Rivers State

**L. A. Nwanyanwu Ph.D & Ogbonnaya, Agatha Nkiru**
Department of Accountancy
Faculty of Management Sciences
Rivers State University, Port Harcourt
adimcvictor@gmail.com

***Abstract***
*This study examined the relationship between budgetary control and financial performance of Small and Medium-sized Enterprises in Rivers State. A population of 74 members list (manufacturing, Construction & engineering and services) of Port Harcourt Chambers of Commerce and sample size of 63 was determined using Taro-Yemen formula. Both primary and secondary data were used, where the hypothesis testing was mostly based on the primary data, and secondary data used in supportive role. Management accounting practices were studied from two dimensions, budgetary control and Marginal Costing while financial performance was measured by Net profit and Return on equity. Technology was employed as the moderating variable. Data were analyzed by using both parametric and non-parametric techniques complementarily. The findings showed that there is a significant relationship at 5% between budgetary control and financial performance. It is the conclusion of this study that budgetary control can be used to drive growth and sustainability of Small and Medium-sized Enterprises in Rivers State. The study recommends that Trade Associations and organized private sectors like the Port Harcourt Chamber of Commerce, Mines & Industries, Manufacturers Association of Nigeria, etc. should periodically organize sensitization workshops for Small and Medium-sized Enterprises on the benefits of implementing budgetary control in their businesses. It is also recommended that private-public-partnership sponsored internship programmes should be established to serve as pool of skilled manpower for Small and Medium-sized Enterprises whose recruitments cannot otherwise be afforded by Small and Medium-sized Enterprises.*

***Keywords:*** *Budgetary Control, Net Profit, Return on Equity, Small and Medium Sized Enterprises*

## Introduction

As today's business environment become increasingly competitive, business organizations are becoming more aggressive and dynamic in identifying strategies that will ensure profitable existence. In order to achieve business sustainability and superior financial performance in the long-run, the need for strategic management has become imperative of business managers. To effectively and successfully design and implement strategic management requires sound management accounting system, the quality of which depends on the management accounting practice of the organization. Adeniji (2013) asserts that information is the lifeblood of an organization. Management accounting practice is necessary for guiding business performance decisions. Anthony & Govindarajan (1997) are of the view that management control decisions are made within the framework established by organization's strategies.

Thus, the management practices of an organization are an indispensable tool in ensuring

efficient and effective resource allocation in the implementation of the strategic objective of the firm. Pricing decisions, operations continuity decisions, product/service portfolio decisions, profit planning decisions and outsourcing decision are some of the several strategic management decisions that directly impact the financial performance of the firm. The quality of these decisions can be enhanced by sound management accounting practices, such as marginal costing and budgetary control. The reliability of information used by managers in this regard depends on the accuracy of the variable overhead estimates (Holland, 2005; Bartle, 2008).

Small and medium sized enterprise (SMEs) are said to be the backbone of all developed and developing nations. Thus, the development of SMEs sector is of paramount importance for any country irrespective of their level of development, since this sector has great potential to generate maximum socio-economic benefits to the country with minimum level of investment. Management accounting techniques are necessary to ensure that SMEs' economic resources are used effectively and efficiently.

According to Richard (2000), the most significant reason for this high failure rate is the inability of Small and medium sized enterprises (SMEs) to make adequate use of essential management accounting practices. Similarly, Wichmann, (1983) argued that one of the reasons for business failure is poor management ability which includes accounting problem-solving. Hopper, Koga, & Goto, (1999) noted that based on the results from Japanese companies that a failure to adopt management accounting practices in a similar way to their larger counterparts may be a factor presently high failure rate of SMEs. In recent years due to the economic crisis and pressures and fierce competition in the market, most SMEs seek new ways and measures to succeed in their organizations. Research has also shown that management accounting practices such as budgetary control have important roles in ensuring the efficiency in the management of the organization and may also improve performance. Management accounting practices also permit firms to compete in the market place and reduce the likelihood of business failure (Lybaert, 1998). The purpose of this study therefore is to examine the relationship between budgetary control and financial performance of small and medium sized enterprises in Rivers State.

## Literature Review

### Budgetary Control

The overall purpose of budgetary control is to help managers plan and control the use of resources in systematic and logical manner to ensure that they achieve their financial objectives, that is profit satisfying (making satisfactory level of profits) and profit maximization (making the maximum profit).

Bendney, Hussy and Colston, (1991) as cited by David (2004) argues that small businesses are relatively easily controlled by one person, usually the owner, but as the business expands, however, there is a tendency to split the organization into parts and employ a specialist manager to run it with a number of specialist line manager who are responsible for the operations of the particular functions. It is important decisions that are made with an overall plan which will ensure that the business as the whole will achieve its agreed objectives as budget will force the management to think ahead to anticipate what is likely to happen. It is essential therefore, that the business develops a formal planning and control system which will state clearly the objectives for both a business as the whole and for each individual functional manager.

Zheng (2009) demonstrated that budgetary control is vital, not just to verify expenditure or income against targets but also to identify changing patterns or circumstances that may give rise to the need for corrective management action or changes in the policy. Consequently, the head of finance should take all reasonable steps to ensure that regular monitoring of all aspects of budget takes place, whether it is income, expenditure, borrowing levels, project progress, operational outcomes or cash flows and the results of such monitoring is appropriately documented.

**Financial Performance**

Financial performance can be defined as a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues (Mills, 2008). This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. The performance measurement concept indicates that employees can increase the value of the firm by; increasing the size of a firm's future cash flows, by accelerating the receipt of those cash flows, or by making them more certain or less risky (Cadbury, 1992).

Carreta and Farina (2010), argue that use of financial performance could still be justified on the grounds that it reflects what managers actually consider to be financial performance and, even if this is a mixture of various indicators like accounting profits, productivity, and cash flow. Financial performance is determined by the following indicators; profit or value added; sales, fees, budget; costs or expenditure and stock market indicators (e.g. share price) and autonomy. Management accounting is thus fundamentally involved with the processes of organizational practice. It must be noted that the major practice system in most organization is the budget.

**Measures of Financial Performance**

**Return on Equity (ROE)**

Ross *et al* (1996) noted that return on equity is a measure of how the shareholders money fared during the year. They further assert that ROE is, in an accounting view the true bottom – line measure of performance. ROE is a measure of profit on investment in equity. Helfert (1991) call this ratio, return on net worth and states that it is the most common ratio used for measuring the return on the owners investment. The ratio of net profit after taxes to common equity measures the rate of return on the stockholders investment (Brigham, 1980).

According to Banker *et al* (1993) the Du Pont formula has long been used to measure the financial performance of companies. They are of the opinion that due to the way in which the profitability ratio is constructed, it provides only a gross aggregate measure and does not easily capture the impact that the micro-attributes of the operations of companies have on profitability.

**Net Profit**

In the business world, profitability refers to the extent to which an organization has added value in its line of activities. Profitability is most often used to assess the ability of an organization to continue in business. The main issue in evaluating profitability of an organization is its profit performance. The term Profit has several definitions, an investor view it as a measure of return on his money. Economists look at it as reward for entrepreneurship for taking risk. An accountant is of the opinion that profit is the excess of income/revenue over expense incurred in producing that revenue.

**Empirical Review**

Wijeywardena and Zoysa (1999) in a comparative analysis of management accounting practices in Australia and Japan investigated the differences in the adoption of management accounting techniques through a survey questionnaire which was mailed to 1000 largest manufacturing companies in each country. The size of the company was based on total assets. A total of 217 Japanese companies and 231 Australian companies responded to the 31 questions asked covering various aspects of managerial accounting techniques. This analysis involved comparisons of techniques in different cultural contexts. Major cultural differences identified in the study were collective decision making, unique company philosophy, usage of small firms as sub-contractors, company specific cost accounting training for each employee, and the difference in educational background of management 20 accountants as seen in Japan compared to Australia.

Adler, Everett, and Waldron (2000) conducted a survey that asked management accountants, in New Zealand manufacturing businesses, to indicate the techniques adopted in their business. While many studies have focused on particular techniques such as ABC or target costing, Adler *et al*. provided a questionnaire that included a vast array of management accounting techniques to provide a fuller set of response options. Respondents 21 were asked to rank management techniques on a five point scale from most used to least used.

**Methodology**

A population of 74 members list (manufacturing, Construction & engineering and services) of Port Harcourt Chambers of Commerce and sample size of 63 was determined using Taro-Yemen formula. Both primary and secondary data were used, where the hypothesis testing was mostly based on the primary data, and secondary data used in supportive role. Management accounting practices were studied from two dimensions, budgetary control and Marginal Costing while financial performance was measured by Net profit and Return on equity. Technology was employed as the moderating variable. Data were analyzed by using both parametric and non-parametric techniques complementarily.

**Results and Discussion**

**Bivariate Analyses**

**Budgetary Control and Net Profit**

As can be observed from Table 4.13, the correlation coefficient between budgetary control (*BC*) and net profit (*NP*) is 0.546. This means that there is a chance of about 29.8% that variability in the net profits of SMEs in Rivers State can be attributable to variability in their budgetary control practices. Thus, low net profit, as observed among SMEs in Rivers State, may therefore be attributable to their low budgetary practices. This trend of association can be observed in table 4.14, where frequency of observations tends to increase towards the lower end (i.e., top-left-hand side) of the scale for both column and row variables.

**Table 1: Budgetary Control Vs Net Profit Contingency table**

| | | Budgetary Control | | | | | |
|---|---|---|---|---|---|---|---|
| | Scale | 1 | 2 | 3 | 4 | 5 | Row Totals |
| Net Profit | 1 | 4 | 31 | 8 | 6 | 0 | 49 |
| | 2 | 12 | 18 | 10 | 6 | 0 | 46 |
| | 3 | 9 | 34 | 5 | 3 | 0 | 51 |
| | 4 | 0 | 0 | 4 | 5 | 3 | 12 |
| | 5 | 0 | 0 | 4 | 5 | 3 | 12 |
| | Col. Totals | 25 | 83 | 31 | 25 | 6 | 170 |

Therefore, based on the *BC* dimension of management accounting practices, and by using *NP* as a measure of financial performance, the correlation coefficient as observed in the correlation matrix (table 4.13) suggests the notion that, SMEs in Rivers State need to improve on their budgetary control practices in order to similarly improve their net profits.

**Budgetary Control and Return on Equity**

Also, the correlation coefficient between budgetary control (*BC*) and return on equity (*ROE*), as obtained from table 4.13 is 0.622, which means that there is a chance of about 38.7% that variability in the return on equity of SMEs in Rivers State can be as a result of variability in their budgetary control practices. Also this might likely explains the low level of return on equity that is observed among SMEs in Rivers State, especially when budgetary control practices among these SMEs are also poor on the average. This trend of association can be observed in table 4.16, where the intensity of observation frequency tends to increase towards the lower end (i.e., top-left-hand side) of the scale for both column and row variables.

**Table 2: Budgetary Control Vs Return on Equity Contingency table**

| | | Budgetary Control | | | | | |
|---|---|---|---|---|---|---|---|
| | Scale | 1 | 2 | 3 | 4 | 5 | Row Totals |
| Return on Equity | 1 | 9 | 37 | 9 | 7 | 0 | 62 |
| | 2 | 12 | 42 | 13 | 9 | 0 | 76 |
| | 3 | 5 | 32 | 9 | 7 | 0 | 53 |
| | 4 | 0 | 0 | 4 | 5 | 3 | 12 |
| | 5 | 0 | 0 | 4 | 5 | 3 | 12 |
| | Col. Totals | 26 | 111 | 39 | 33 | 6 | 215 |

Therefore, from the *BC* dimension perspective of management accounting practices, and by using *ROE* as a measure of financial performance, the correlation coefficient as observed in the correlation matrix (table 4.13) suggests the notion that, SMEs in Rivers State need to improve on their budgetary control practices in order to similarly improve their return on equity.

**4.3.1 Results of Analyses: non-parametric approach**

**Test 1**

Null Hypothesis ($H_{01}$): There is no significant relationship between budgetary control and net profit of small and medium sized enterprises in Rivers State

Level of significance: 0.05

Rejection Criterion: The rejection region is defined by the level of significance and degree of freedom. At level of significance of 0.05, $H_0$ is rejected if $X^2_{computed} > X^2_{0.05,(r-1)(c-1)}$

Data used: Contingency Table on Budgetary Control and Net profit (Table 4.14 of Section 4.2.2)

**Result**

Degree of freedom: = (5 – 1) (5 – 1) = 16

$X^2_{computed}$ = 84.076

P-Value: = 0.00000

Critical value $\left(X^2_{0.05,16}\right)$ = 26.296

**Decision: Reject null of independence**

Therefore test result shows that budgetary control of SMEs in Rivers State is NOT independent of their net profit.

**Test 2**

Null Hypothesis ($H_{02}$): There is no significant relationship between budgetary control and return on equity of small and medium sized enterprises in Rivers State.

Level of significance: 0.05

Rejection Criterion: The rejection region is defined by the level of significance and degree of freedom. At level of significance of 0.05, $H_0$ is rejected if $X^2_{computed} > X^2_{0.05,(r-1)(c-1)}$

Data used: Contingency Table on budgetary control and return on equity (Table 4.16 of Section 4.2.2)

**Result**

Degree of freedom: = (5 – 1) (5 – 1) = 16

$X^2_{computed}$ = 82.121

P-Value: = 0.00000

Critical value$\left(X^2_{0.05,16}\right)$: = 26.296

**Decision: Reject null of independence**

Therefore test result shows that budgetary control of SMEs in Rivers State is NOT independent of their returns on equity.

**Discussion of findings**

The foregoing analyses involved a test of degree and direction of association between budgetary control and financial performances of SMEs in Rivers State. Financial performance was measured with net profit and return on equity. At 5% level of statistical significance, marginal costing and budgetary control practices of SMEs in Rivers State were found to be significant in associating positively with their net profits and returns on equity respectively. Budgetary control account for between 59% and 65% of the financial performances of SMEs in Rivers State, implying that recording improvements in the budgetary control practices can result in significant improvement in their financial performances. The validity of the notion, that improved budgetary control practices will result in improved financial performance, is true only for a given state of technology prevailing at a point in time, which is held constant.

**Conclusion and Recommendation**

The study examined budgetary control practices and financial performance of the selected small and medium sized enterprises in Rivers State. The result showed that budgetary practices have significant positive relationship with financial performance in SMEs surveyed. In spite of the numerous benefits that can be derived from adoption of management accounting practices, most SMEs maintain low profile on budgetary control practices and consequently their financial performances are poor. Judging from the perspective of Resource dependency theory, it can be concluded that SMEs' owners'/managers' failure to secure the needed resources is responsible for their managerial ineptitude in the aspect of management accounting practices application. For instance, if SMEs had invested considerable portion of their resources in the procurement and training of qualified human resources in the area of

management accounting practice, it is highly probable that their financial performance should have been better than it is.

In a nutshell, budgetary control techniques if properly harnessed by SMEs, can be used to drive growth and sustainability of SMEs in Rivers State, thereby creating employment and eventual growth and development of the economy of Rivers State.

Based on the findings from this study, the following recommendations are made to the management of the various small and medium sized enterprises for improved management accounting techniques and financial performance. Trade Associations and organized private sectors like the Port Harcourt Chamber of Commerce, Mines & Industries, Manufacturers Association of Nigeria (MAN), etc. should periodically organize sensitization workshops for SMEs on the benefits of implementing management accounting techniques in their businesses. Private-Public-Partnership sponsored internship programmes should be established to serve as pool of fresh graduates whose recruitments cannot otherwise be afforded by SMEs. For instance, ICAN and ANAN should partner with governments at state level to compel every newly qualified member of their bodies to do a one year internship at SMEs.

**References**

Abdel-Kader, M., & Luther, R. (2006). Management accounting practices in the British food and drinks industry. *British Food Journal*, *5* (3), 336-357.

Abdel-Kader, M.G. &Wadongo, B. (2011). Performance management in NGOs: evidence from Kenya. Available at SSRN: http://ssrn.com/abstract=1909863 Alleyne, on 10th June, 2012.

Ainikkal, J. (1993). Exploring the New Zealand Manufacturing Environment.*The Accountants' Journal, 72* (6), 23-56.

Baird, K. (2007). Adoption of Activity Management Practices in Public Sector Organizations.*Accounting and Finance*, *47*(3), 551-569.

Bartle, J. R. (2001 ). *Evolving Theories of Public Budgeting.*Port Harcourt:JAI Press.

Burns, J., Ezzamel, M. &Scapens, R.S. (1999). Management Accounting Change in the UK. *Management Accounting*, *77*(3), 28-30.

Cadbury, A. (1992). *Report of the Committee on the Financial Aspects of Corporate Governance*. London: Gee Enterprises.

Chartered Institute of Management Accountants.(2000). *Management Accounting Official Terminologies.CIMA.*

Garrison, R., Noreen, E., and Seal, W. (2003).*Management Accounting*. New York: McGraw-Hill Education, European Edition.

Horngren, C.T., Datar, S.M. &Rajan, M.V. (2012). *Cost Accounting: A Managerial Emphasis* (14th ed.). New Jersey: Pearson Prentice Hall.

Isa, C.R. &Thye, N.K. (2006) Advanced Management Accounting Techniques: An Exploratory Study on Malaysian Manufacturing Firms.

Ittner, C. &Larcker, D. (2001).Assessing Empirical Search in Managerial Accounting: A Value-Based Management Perspective.*Journal of Accounting and Economics*, 32(3), 349-410.

Libby, T & Lindsay, R. (2010). Beyond Budgeting or Budgeting Reconsidered? A Survey of North-American Budgeting Practices.*Management Accounting Research,* 2(1), 56-75

Libby, T. & Waterhouse, J.H. (1996).Predicting Change in Management Accounting Systems.*Journal of Management Accounting Research*, 1 (8), 137-154.

Lin, Z.J. & Yu, Z. (2002). Responsibility Cost Control System in China: A Case of

Management Accounting Application. *Management Accounting Research,* 13 (4), 447-467.

Lucey, T. (2009).*Costing* London: DP Publications.

Mills, A. (2008). *Essential Strategies for Financial Services Compliance.* Port Harcourt:John Wiley & Sons, Ltd.

Ndwiga, N.M. (2011). The Role of Management Accounting in Creating and Sustaining Competitive Advantage: A Case Study of Equity Bank, Kenya. *Unpublished Master of Commerce Thesis*, University of South Africa.Accessed on 8 April 2017 from http://uir.unisa.ac.za/handle/10500/5047.

Obadan, M. &Uga, E. (2000).Plan-Budget Link and the Budgeting Process.*A Paper at the Round Table Organised by the African Centre for Development Research,* Day Spring Hotel, Abuja.

Rowe, C., Birnberg G. & Shields, M. (2008).Effects of Organizational Process Change on Responsibility Accounting and Managers' Revelations of Private Knowledge.*Journal of Accounting, Organizations and Society, 33*(23), 164-198.

Smith, M. (2009).Management Accounting for Competitive Advantage (First Edition). Sydney: LBC Information Services. 61.

Wairegi, B. W. (2011). Accounting Systems in Small and Micro Enterprises in Kenya. *Journal of Language, Technology and Entrepreneurship in Africa, 3*(1), 79-98.

Wald, J. (1984). *Biggs's Cost Accounting.* 11th ed. Port Harcourt: MacDonald and Evans Ltd.

Waweru, N.M. (1999). A Survey of Management Accounting Practices by Publicly Quoted Companies in Kenya.*Unpublished MBA Thesis*, University of Nairobi.

Waweru, N.M., Kamasara, V.O&Anyagu, M. (2003). Management Accounting Practices in Kenya: A Survey. *University of Nairobi Journal of Management*, 6(6), 67-90.

Weygandt, J. J., Kimmel, P. D. &Kieso, D. E. (2012).*Accounting Principles* (10th ed.). Hoboken, NJ: John Wiley and Sons, Inc.

Wijewardena, H. &Zoysa, A.D. (1999). A Comparative Analysis of Management Accounting Practices in Australia and Japan: An Empirical Investigation. International *Journal of Accounting,* 34(1), 49-70.

Wood, E.G. (1984).*Cost Matters for Managers*. London: Business Books Ltd.

Yuen, D. (2004). Goal Characteristics, Communication and Reward Systems and Managerial Propensity to Create Budgetary Slack.*Managerial Auditing Journal*. 19 - 21.