PLANNING & BUDGETING FOR MICRO-CREDIT

2022

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BUDGETING

A budget is a key management tool for planning, monitoring and controlling the finances of a micro-creditor. It estimates the income and expenditures for a set period of time for your project or organisation. It is a financial plan showing income and expenditure for the year ahead (money in and money out). It helps you to identify what money you need to cover your costs and helps you control your expenditure, monitor your income and manage your money. No budget is ever 100% accurate. It is usually just a guess at what you will need when you prepare your project plan. Things are likely to change in the course of the year ahead, some costs may increase and similarly some may be less. You need to keep a close watch on your budget and the more time goes into it the more accurate it is likely to be.

IMPORTANCE OF BUDGETING

Your budget can serve a number of important purposes, including:

Facts

Budgets usually represent a detailed analysis of how an enterprise expects to spend money in future time periods. Most lenders create budgets on an annual basis so they can carefully outline the expected needs in the business. Using an annual budget process also limits the amount of time Micro- Creditors spend creating and managing capital resources. Although larger lending enterprises may have employed accountants or other professionals to create the business budget, small lending enterprise owners are usually responsible to complete this function themselves.

Limit Expenditures

A major benefit to using a business budget is the ability to limit how much money is spent on certain operations. Budgets usually count expense accounts to ensure that capital is not wasted on unessential items or the enterprise does not overpay for economic resources used in the business. Limiting the amount of capital spent by the business may require owners and managers to find new vendors or suppliers for acquiring business inputs, saving money and meeting budget limits.

Creates Financial Roadmap

Budgets often allow enterprises to have a financial roadmap for business operations. Many Micro- Creditors review previous years' budgets to determine how well they followed the guidelines and why variances occurred in budgets. Not all budget variances may indicate a negative business situation. If budget variances occurred due to unexpected growth in sales revenue, Micro- Creditors may need to increase the budget amounts for future sales increases.

Plan for Future Growth

Micro- Creditors often use budgets to plan for future business growth and expansion. Capital saved on regular business expenditures may be placed into a special reserve account designated for selecting new business opportunities. Budgeting for future growth opportunities ensures that Micro- Creditors have capital on hand when needing to make quick decisions for expanding business operations. This capital may also be used during slow economic times as a safety net for paying regular business expenses.

PROBLEMS IN BUDGETING

Whilst budgets may be an essential part of any marketing activity they do have a number of disadvantages, particularly in perception terms.

1. Budgets can be seen as pressure devices imposed by management, thus resulting in:

    a. bad labour relations

    b. inaccurate record-keeping.

2. Departmental conflict arises due to:

    a) disputes over resource allocation

    b) departments blaming each other if targets are not attained.

3. It is difficult to reconcile personal/individual and corporate goals.

4. Waste may arise as managers adopt the view, "we had better spend it or we will lose it". This is often coupled with "empire building" in order to enhance the prestige of a department.

5. Responsibility versus controlling, i.e. some costs are under the influence of more than one person, e.g. power costs.

6. Managers may overestimate costs so that they will not be blamed in the future should they overspend.

BUDGET PREPARATION - KEY SUCCESS FACTORS

1. Align Budget with Business Plan

First and foremost, the budget needs to be aligned with your business plan. Business plan sets out business strategies for the following year and is normally directed by credit and finance team as the core driver. Budget is the financial target including both top line and bottomline and is driven by finance team. The objectives of doing business plan is to increase revenue and market share, eventually maximising operating profit. A good budget illustrates the roadmap of how business strategies are turned into revenue and profit. A business plan unquantified is slogan display and a budget with no qualitative action plans is full of illogical figures.

2. Set the right tone from the top:

This is a value system issue. It is important for leaders to believe in the value of the budgeting mechanism that can bring to an organisation and to take everyone through in focus. The right tone must come from the top, CEO, Managing Director, or General Manager, though he or she may not be personally leading the process. Leaders' biased position towards budget will be passed on to the employees thus creating misperception about the budget.

3. Communicate effectively:

One can easily tell from above two points that effective communication is essential.

Top down communication to set the right tone is necessary.

Thorough discussion between functions to ensure successful implantation of budgets requires effective communication skill, sometimes negotiation skill too.

What I want to focus here is another perspective - effective communication on the right things without fear. At any budget discussion, one is bound to face many challenges from various parties. Top management may force you to do more revenue or cut more expenses, or give your organisation more money to spend tasking you with higher return on revenue. Be bold to express your dissent with justifiable facts and data to support your view if the request is unrealistic, even the attempt fails. It is even more critical for managers who are in a decision-making position where you can finalise the targets for business units you are responsible.

4. Build up accountability

Setting a budget without holding managers and employees accountable does not serve any purpose. One can aim high, but without carrot and stick, it is unlikely that people will follow the directions seriously, or even resist it. It is as good as showcasing the best to the stakeholders concerned, but it is an illusion that will never be crystallised. It is human nature. Who would like to do more without knowing the incentives of doing more? Who would like to do more if they are rewarded equally with people who do less, or even fail? Budgeting becomes a boss-flattery event and will never be taken seriously without accountability.

HOW TO PREPARE A BUDGET

FORMULATE A PROFIT PLAN

The preparation of a budget begins with the formulation of a profit plan. Profit is an essential cost of business activities and must be planned and managed just like other costs. Successful business performance requires balancing costs and revenues as illustrated by the model below:

Profit + expense = revenue.

The micro-creditor must make trade-offs among these variables and keep this equation in balance, and this requires effective profit planning.

What is a profit plan?

Profit plan is a set of steps that are taken by micro-creditors to achieve their desired level of profit.

1. The managing director has the coordinating responsibility for formulating profit plan.
2. The managing director and management are responsible for implementing the profit planning process.
3. All management members will aid in determining the institution's resources, abilities and needs.

STEPS IN FORMULATIONG YOUR PROFIT PLAN

We would go about the steps using the model described above (Profit + Expense = Revenue)

1. **Know the period of your plan**

Until you set a period which you are planning for, you cannot plan. We do not plan for forever. We plan for a period.

So, now, let us set up our budget period. We are planning for a twelve-month period from January 1st, 2023 to December 31st, 2022.

2. **Set up your profit goal.**

Setting up a goal is always the first step in planning. So setting up your profit goal is the first step of profit planning. This stage is so important to your budgeting as it becomes the soul of your budget. The goal should be realistic and achievable so the staff can commit its self to achieving it. Profit goal should consider tax implications. It is quite confusing but very simple to forecast.

1. Set up the profit you want to bag at the end of the period. In my case GH¢ 20,000.00
2. Know your tax rate. In my case 20%

3. Note that if the government is taking 20% of your profits, then you are taking home 80%.
4. Divide the profit after tax you expect to earn by how much you can take home. In my case, I divide GH¢ 20,000.00 by 80% and I get GH¢ 25,000.00.
5. This means I get GH¢ 25,000.00 profit before tax. If I am getting GH¢ 20,000.00 after tax then it means I am paying GH¢ 5,000.00 as tax.

Now, let us set a profit after tax goal. Our goal is to make a profit of GH¢ 20,000.00 after tax for the three month period.

Set-Up Expense Plan

1. At this stage, you plan on how you are going to spend. It is important you remember the types of expense. Here, we focus on the revenue expenditure.
2. List all your expenses and then attach amounts of spending to it as illustrated below:

EXPENSE	
Interest Expense	2,880.00
Personnel Expense	9,000.00
Depreciation	550.00
Internet Expense	255.00
Rent	600.00
Utilities	600.00
Insurance	330.00
Subscriptions & Dues	500.00
Stationery and Printing	300.00
Fuel & Lubricants	1,700.00
Repairs and Maintenance	690.00
Cleaning and Sanitation	135.00
Traveling and Transport	360.00
Food and Refreshment	150.00
Bank Charges	150.00
Postage and Communication	150.00
Provision for Loan Impairment	1,600.00
Total Expense	**19,950.00**

Please note that these figures are not the actual figures; these are figures used purposely for the purpose of this illustrations.

In forecasting this estimates as I have done in the table above, you put into consideration certain factors. Such factors are:

1. History (past experiences, past records, past reports, etc.)
2. Government policies (e.g. relating to wages, interest rates, utilities, taxes, etc.)
3. Economic indicators (inflation, fiscal policies, interest rates, standard of living, etc.)

These would help you make accurate estimates for your business. Accuracy is key here. You would not get it 100% right but 5% margin of error giving 95% accuracy level of your forecast is better.

FORECAST YOUR INCOME

Now that we have our profit goal and expense forecast, we can now forecast our income. Using the model described above, profit + expense = income, we have

Profit to be GH¢ 20,000.00

Expense to be GH¢ 24,950.00

Therefore, our income target is GH¢ 44,950.00.

Now that you know how much income you are to realise in the period, you can apportion it to your various income streams depending on your history of operation. If a new business, please consult or research on the best estimates to use.

In my case, history shows that 80% of my income comes from interest income and 20% from fees and commission income. This means my interest income is GH¢ 35,960.00 and my fees and commission income is GH¢ 8,990.00

INCOME	GH¢
Interest Income	35,960.00
Fees and Commission Income	8,990.00
Total Income	**44,950.00**

Now what do we have? We have our profit plan which has become our forecast income statement (Profit and loss statement) as illustrated in figure 1.2

Figure 1.2 – Income statement (Profit plan)

TRUST MICRO-CREDIT ENTERPRISE
FORCAST PROFIT AND LOSS (PROFIT PLAN)
FOR THE PERIOD JANUARY TO DECEMBER 31, 2023

	GH¢
INCOME	
Interest Income	35,960.00
Fees and Commission income	8,990.00
Total Income	**44,950.00**
EXPENSE	
Interest Expense	2,880.00
Personnel Expense	9,000.00
Depreciation	550.00
Internet Expense	255.00
Rent	600.00
Utilities	600.00
Insurance	330.00
Subscriptions & Dues	500.00
Stationery and Printing	300.00
Fuel & Lubricants	1,700.00
Repairs and Maintenance	690.00
Cleaning and Sanitation	135.00
Traveling and Transport	360.00
Food and Refreshment	150.00
Bank Charges	150.00
Postage and Communication	150.00
Provision for Loan Impairment	1,600.00
Total Expense	**19,950.00**
Operating Profit (Profit before tax)	**25,000.00**
Tax @ 20%	5,000.00
Profit After Tax (Profit Goal)	20,000.00

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SOURCE AND USE OF FUNDS

Now that we need an income of GH¢ 44,950.00 and spend GH¢ 24,950.00 out of it in the period to make a net profit after tax of GH¢ 20,000.00. The questions are:

1. What do I need to meet this profit target?
2. How do I fund what I need to meet this profit target?

The summary of these questions leads to what we call the statement of financial position or the balance sheet.

WHAT DO I NEED TO MEET THE PROFIT TARGET?

To achieve this target means you need to be operationally functional. To be operationally functional in this business means you need resources and this answers the question I always hear from start-ups. What resources do you need?

The resources you need are:

1. Office space
2. Cash to disburse and also pay for spending
3. Loan portfolio to raise the income
4. Computer sets
5. Furniture
6. Office Equipment
7. Transport system (Thus means of reaching you clients. e.g. Motor vehicle, bicycle, etc.)

These resources are like the blood in your business. Without the blood, you can survive and limited blood means a weaker being. Please note that the above listed resources are the exact resources you need to carry on your business. This list is for illustration purpose. Now let us analyse these resources in detail.

- **Office Space**: Except you are a deposit-taking financial institution, this is not much of requisite requirement. In this illustration, I am renting an office space. You have to know how much rent charge is per month and how many years advance you are renting if you are to start-up. If you are already in business, know how many years advance you have remaining and consider if you are going to rent a new space or pay more advances within the period of budget.
  For illustration purposes, the rent amount per month is GH¢ 200.00 and my landlord is seeking for two years' advance. This means I am paying GH¢ 4,800.00 for the two-year period.
  If it is a start-up, you would consider GH¢ 4,800.00 as part of your start cost. Since we are preparing a budget not a start-up cost, the unconsumed rent balance become your (our) balance to show on the balance sheet i.e. GH¢ 4,200.00. So therefore since it is a budget for a three month period, GH¢ 600.00 has already be consumed and this form part of our period expenses.

Please note that not all the GH ¢ 4,800.00 would be charged as expenses for the period. It is only the consumed part which is GH¢ 200.00 for three months.

- **Loan Portfolio:** This is a very important component of a budget for a micro-creditor. Your loan portfolio is the heart of your business, without that there is no business. In forecasting for the loan portfolio, you put into consideration:
  - Income level required
  - Yield on the loan portfolio

  We know of the amount of income we want to raise already from our profit plan. The challenge here would be the yield on portfolio. The yield on portfolio indicates the micro-creditors ability to generate cash from interest, fees and commissions on the gross loan portfolio. It does not include any revenues that have been accrued but not paid in cash. It is calculated by summing all income realised from your loan portfolio only and dividing your answer by the average loan portfolio.

  This rate is quite simple to obtain if you are already operating. You can get this by calculating the previous years' rate and analysing the trend to choose a rate that suits your business operations. In a case where you are a start-up, you would have to research for this rate from other competitors data, regulators secretariat, GHMAFIN secretariat, etc.
  After you have your yield on portfolio and your income level, you can now calculate the amount of portfolio balance you need to have to meet your profit target by dividing the Income level by the yield on portfolio.
  In the case of the illustration, the yield on portfolio from my research ranges from 35% to 38%, so I choose the minimum yield (35%) to make room for fluctuations. This implies that I need an average portfolio of GH¢ 128,429.00 (44,950 / 35%) or more throughout the period to generate GH¢ 44,950.00 income. Very simple right?

- **Cash:** The foundation of this business is built on cash. Without cash, you would find it difficult to survive. Let us just say you are selling money so you need money to sell. If you are a start-up, you would need a cash of the total of:
  - The expense for the period (19,950.00)
  - The total assets (GH¢143,400.00)

  If you are a continuing business, the cash you require in the period depends on the:
  - Loan portfolio balance you need
  - Other asset acquisition

  For the case of this illustration, we are a start-up, so we need GH¢163,350.00. This would just be left with GH¢ 2,221.00 at the end of the three month period after paying for rent, acquiring assets, disbursing loans.

- **COMPUTER SETS, FURNITURE, OFFICE EQUIPMENT AND TRANSPORT SYSTEM**

  Since you are running an office, these items one way or the other would be inevitable. In preparing your budget, you have to put into considerations the acquisitions of these items. These items are all assets, they would be probably be used for a period more than one financial year and so are called non-current assets. If your business is a continuous one, you would probably have some of these items already. All you have to do is to consider the efficiency levels of the existing one and see if it would need replacement or any additions. If you are a start-up, you would have to be very particular in deciding the values you use for these items in your budget.

  In the case of the illustration, I am budgeting to have a small office which would contain one staff and myself. So I would need:

2 set of office furniture at GH¢ 1,500.00 each and 6 set of visitors chair at GH¢ 300 each	Total of GH¢ 4,800.00
2 set of laptops at a cost of GH 1,500.00 each	Total of GH¢ 3,000.00
A set of office equipment costing GH¢ 1,500.00	Total of GH¢ 1,500.00

Now that you know of the resources that you would need to meet your profit target, you actually have completed one part of your balance sheet which is the Total Asset.

How do I fund what I need to meet this profit target?

This is where the thinking goes in. Now you know you need an amount of GH¢ 143,400.00 to be able to meet the said profit target. How do you get this amount of money? That depends on you. The possible sources of financing this amount are:

1. Owner equity: personal investments
2. Loans from family and friends
3. Loans from financial institutions
4. Grants from agencies
5. Managed funds
6. Retained profit from period operations

It is very important to always ascertain if you can meet the funding requirements to finance the business. In a case where the funds available do not meet the required investment needed to meet the profit targets, you would have to do any of the following to meet and have a trade-off between the resources needed and the funding available:

1. Reduce the profit target
2. Reduce and manage expense
3. Find substitutes for the resources needed. This should not compromise the expected efficiency.

In the case of the illustration, I am going to fund the GH¢ 143,400.00 capital requirement by investing GH¢ 100,000.00 from my personal savings, reinvest the profit of GH¢ 20,000.00 realised for the period and take a loan of GH¢ 23,400.00 from Opportunity International Savings & Loans.

Illustrated in figure 1.3 is my budgeted balance sheet showing statement of financial position for the three months period.

Figure 1.3 – Forcast Balance Sheet

TRUST MICRO-CREDIT SERVICES
FORCAST FINANCIAL POSITION
FOR THE PERIOD JANUARY TO DECEMBER 31, 2023

	GH¢
Current Assets	
Cash	2,221.00
Loan Portfolio	128,429.00
Provision for loan impairment	(1,600.00)
Rent	4,200.00
Inventory	850.00
Total current Asset	134,100.00
Non- Current Assets	
Computer and Accessories	3,000.00
Furniture	4,800.00
Office Equipment's	1,500.00
Total Non- Current Assets	9,300.00
Total Assets	143,400.00
EQUITY & LIABILITY	
Owner Equity	100,000.00
Profit for the period	20,000.00
Short Term Loan	23,400.00
Total Equity & Liability	143,400.00

BUDGET CONTROL

Budgetary control is involves preparation of Budgets, coordinating the departments and establishing responsibilities comparing performance with budgeted and acting upon results to achieve the maximum profitable.

The process of budgetary control includes:

1. Preparation of various budgets.

2. Continuous comparison of actual performance with budgetary performance.

3. Revision of budgets in the light of changed circumstances.

A system of budgetary control should not become rigid.

There should be enough scope of flexible individual initiative and drive. Budgetary control is an important device for making the organization an important tool for controlling costs and achieving the overall objectives.

Budgetary control serves 4 control purposes:

1. They help the manager's co-ordinate resources;

2. They help define the standards needed in all control systems;

3. They provide clear and unambiguous guidelines about the organization's resources and expectations, and

4. `They facilitate performance evaluations of managers and units.

BUDGET CONTROL TECHNIQUE

1. Variance Analysis

First of all, budgets of different departments are made with estimated figures. After this, it is compared with actual accounting figures. In this technique, we find variances. These variances may be favourable and unfavourable. For example, we have recorded actual quantity and cost of our raw material, after this, it is compared with budgeted value of raw material quantity and cost. Result of this will be material cost variance. Like this, we will find the variance of labour cost and overhead cost. This technique of budgetary control is helpful for reducing the cost of business.

2. Responsibility Accounting

Responsibility accounting is also a good budgetary control technique. In this technique, we create cost centre, profit centre and investment centre. All these centres are just like department of any organisation. Now, we classify our all employees work on the basis of their centres. Every employee's responsibility is fixed on the basis of his target or performance. After this, we record their performance manually. Then, we fix their accountability. For example, we have fixed the target of credit department at GH¢ 50,000 loan disbursement per month. For this, we have appointed good credit officers. But credit department's total per month disbursement is GH¢ 30,000 which is GH¢ 20,000 less than our Credit department target. Through this budgetary control, we can take the decision of promotion and demotion of our employees or find other reasons if we do not obtain our targets.

3. Adjustment of Funds

In this technique of budgetary control, top management take the decision to adjust fund from one budget line item to other . For instance, if a budget line item by an organisation needs money and there is surplus money allocated to an already existing budget line item, then the surplus funds can be adjusted against new budget line item for its initial setup. This technique facilitates proper allocation and adjustment of funds and prevents misuse.

4. Zero Base Budgeting (ZBB)

These days zero base budgeting is popular technique of budgetary control. In this technique, every next year budget is made on nil base. It can only be possible, if your estimated income will be equal to the estimated expenses. At that time, difference between estimated income and estimated expenses will be zero. If there is any excess, it will be adjusted. For example, if your estimated revenue is more than estimated expenses, you need to increase the amount or allocate in new estimated expenses. With this, nothing will go to next year. With zero base budgeting technique, you can control on every money which you have to spend. Its base will be the current year income only.

BUDGET VARIANCE ANALYSIS

Budget variance analysis is concerned with the difference between budgeted and actual values for a given period of time. By analyzing the variances for line items, projects and target you can monitor and improve performance, as well as catch potential problems early.

The more you break down your budget into individual items, the more useful the analysis will be. If you group items together, it's possible that you'll miss important variances, as the performance of some items could be compensating for others. Spreadsheet software like Excel or Google Sheets can help you do this efficiently and regularly.

What is the Purpose of a Budget Variance Report?

Budget variance reports allow you to investigate interesting or worrying differences between the expected and the actual. The finance team needs to provide possible explanations for these variances. In some cases, this may require digging deeper into specific aspects to investigate potential problems or opportunities.

Doing research on anomalous or unexplained budget variances can be time-consuming, so it's important to first determine whether a particular variance is worth investigating. It's not a pleasant subject, but it can help you avoid serious consequences, such as small-time fraud. By doing variance analysis regularly, you're more likely to catch discrepancies in your budget earlier, limiting the damage to your enterprise.

How Do You Calculate Budget Variance?

Budget variances are calculated by subtracting the actual values for each line item from the budgeted value for that line item. This will get you a positive result if the real value is lower than you expected and a negative result if it's higher than expected.

Budget variance = Budget value - Actual value

Some prefer to reverse the polarity by subtracting the budgeted from the actual, giving you a negative result if the value is lower than you expected. While either will work equally well, it's very important to be consistent in their use –that's exactly why we recommend automating this process.

Now that you know how the variance is calculated let's have a look at the steps involved in the analysis itself.

1. Gather data

First, you need to gather all the relevant data in one file. This includes the originally budgeted values and the actual values for all line items.

2. Calculate variance

Once you have your data, you need to subtract the actual value from the budgeted value for each line item.

3. Analyze variance

Now that you have the variances, you need to look for any discrepancies and figure out the cause. Most are easily explained by external changes that you don't control - price changes, competitor strategies, etc. - but some may require more extensive research.

4. Report findings

Finally, you need to build a report summarizing your analysis, including any suggestions or recommendations based on your research.