



CONVENTIONAL BUDGETING IN A CHANGING ENVIRONMENT

Management Accounting (SBUS5120)



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Introduction

There has been a lot of talk on traditional budgeting and beyond budgeting lately. This paper will critically discuss Traditional budgeting, it will review how budgeting has evolved over the last 50 years. There will be a brief description of alternatives to traditional budgeting; even so, the focus will be on traditional budgeting and beyond budgeting. The paper will seek to establish the effectiveness and use of budgeting and whether it has served its purpose or whether it is still relevant in today's dynamic and ever-changing business environment.

Furthermore, the paper will examine Beyond Budgeting, the merit of beyond budgeting over traditional budgeting; and why big corporations are abandoning Traditional Budgeting and in favour of Beyond Budgeting. The paper will seek answer if beyond budgeting can fully resolve the shortcomings of Traditional Budgeting.

Traditional Budgeting

The term budgeting was introduced in the 1920's to assist managers to control costs and cash flows, and it became a form of fixed contract to measure performance between senior management, and managers this was in form of a plan by estimating future income and expenditure (CIMA, 2007). Nonetheless, governments have been using budgeting since 1750s (Appendix 1). The purpose of budget is to plan, organise and control an organisation (Appendix 1a; Biant, 2013).

(CIMA, 2008) Defined budget as 'A quantitative expression of a plan for a defined period. It may include planned sales volumes and revenues, resource quantities, costs and expenses, assets, liabilities and cash flows'. The essence of a budget is to facilitate planning, control and monitoring of organisational operations. The purposes of budget is to support strategic plans of an organisation

and to minimise uncertainty and make the future more predictable (Appendix 2). Drury, (2015) suggested that before preparing a budgeting, organisation would have prepared a long-term plan known as strategic plan. The term strategic plan encompasses the vision, mission and objectives. Future operations are directed by this strategic plan. One of the limitations with long-term plan is that managers are expected to look into the future. Unfortunately, the future could be uncertain, volatile, imprecise and subject to change, besides, the long-term plan is between five to ten years. The Plan is called a budget and is usually for a year, and is expressed in financial terms. Notwithstanding, Budget has many benefits (Appendix 3)

Atrill & McLaney, (2015) Proposed that budgets will state items such as Cash receipts and payments, sales volumes and revenues for each of the products or services provided by the business, the budget detail the inventories and labour requirements. Many authors including Atrill & McLaney, (2015) propose the budget planning and control process which is shown in a graphic form in (Appendix 4), and once the budgets are prepared, it must be communicated to all responsible parties for it be effective.

Criticisms and Limitations of budgets

Atrill & McLaney, (2015); Biant, (2013a) argued against budgeting by proposing that budget cannot deal with rapid change, that budget encourage a top-down management, very time consuming. According to Hackett group, 73% of companies spend more than 3 months in completing the annual budget (Biant, 2013b), it encourages incremental thinking, budgeting sometimes focuses on short-term financial targets, budget is not a statement of fact but only an estimate, it does not guarantee success to name a few.

Fig 1 Limitations of budget

Limitations of budgets

- Only estimates, not statements of facts.
- No substitute for sound management practices.
- Need to be amended if circumstances change.
- Preparation does not guarantee success.
- Aspects of people's behaviour may undermine the value of the process.

(Biant, n.d., p. 1291)

Fig 2 Criticism of budget

Budgets are bad for business?

Main criticisms of budgets are

- *Too resource and time consuming*
- *Slow to detect problems*
- *Not reliable for performance evaluation*
- *Quickly out of date*
- *Game Playing (Agency Problem)*
- *Financial targets overwhelming what is good for the business and ultimately shareholders*
- *Over emphasis on short term financial measures*
- *Departmental budgets may encourage "silo" thinking*
- *Disrupts cooperation*
- *Discourages innovation and adaption to changing conditions and opportunities*
- *Process lacks rigor*

(Biant, n.d., p. 1293)

Again, Behavioural aspect of budgeting can affect a budget (Appendix 5). Despite the limitations of budgeting, it is still widely regarded as useful. Atrill & McLaney, (2015) supposed that many organisations that claimed to have abandoned budgeting use other planning and control devices that appear to be budgets by another name.

1. Conventional budgeting in a changing environment.

The General Electric Chairman Jack Welch argued that budgeting process is “the most ineffective practice in management (AMA, 2018). The AMA, (2018), stressed three problems with budgeting as

1. It takes a long time, costs too much, and consumes too many corporate resources.
2. It is fixed and inflexible, and can quickly become irrelevant
3. Most companies tie executive and employee compensation directly to performance against the budget.

Traditional budgetary control is a costly and burdensome routine, reinforcing bad practice and constraining response in a rapidly changing environment. In 2003, the Hackett Group reported that over 25,000 person-days per billion dollars were spent putting together the annual budget and are proposing the Rolling forecast to replace the traditional budget (AMA, 2018).

3. Alternatives to Traditional Budgeting

3.1 Activity Based Budgeting

Kaplan and Bruns first defined ABC in the late 1980s; CIMA, (2008), they describe ABC as a budgeting method that is built on activities. ABC employ cost driver data in the budget setting and variance feedback processes. Under ABC, resources are allocated to activities and then activities to cost objects. The latter use cost drivers to attach activity costs to outputs (CGMA, 2013; fig 4; Appendix 6).

Fig 4 ABC Dos and Don'ts

Actions to take / Dos	Actions to Avoid / Don'ts
• Get buy-in from the rest of the business. ABC provides business managers, as well as the finance function, with the information needed to make value-based decisions • Use ABC for pricing and product prioritisation decisions • ABC should be implemented by management accountants as they are best placed to manage the process and to ensure benefits realisation	• Do not get caught up in too much attention to detail and control. It can obscure the bigger picture or make the firm lose sight of strategic objectives in a quest for small savings • It is important not to fall into the trap of thinking ABC costs are relevant for all decisions. Not all costs will disappear if a product is discontinued, an example being building occupancy costs

(CGMA, 2013)

3.2 Rolling Budgeting

A rolling or continuous budget is a budget that is continuously updated at a regular interval usually a month or quarterly. By adding a further accounting period when the prior accounting period expires. This system is especially useful when it is impossible to accurately forecast the key budget elements (CIMA, 2008).

3.3 Zero Based Budgeting

Under ZBB, the company begins budgeting from Zero point. Budgeting is not based on historical data and each budgeting process begins afresh. Nonetheless, the responsible officer must justify the usefulness of activity (Cheong, 2012).

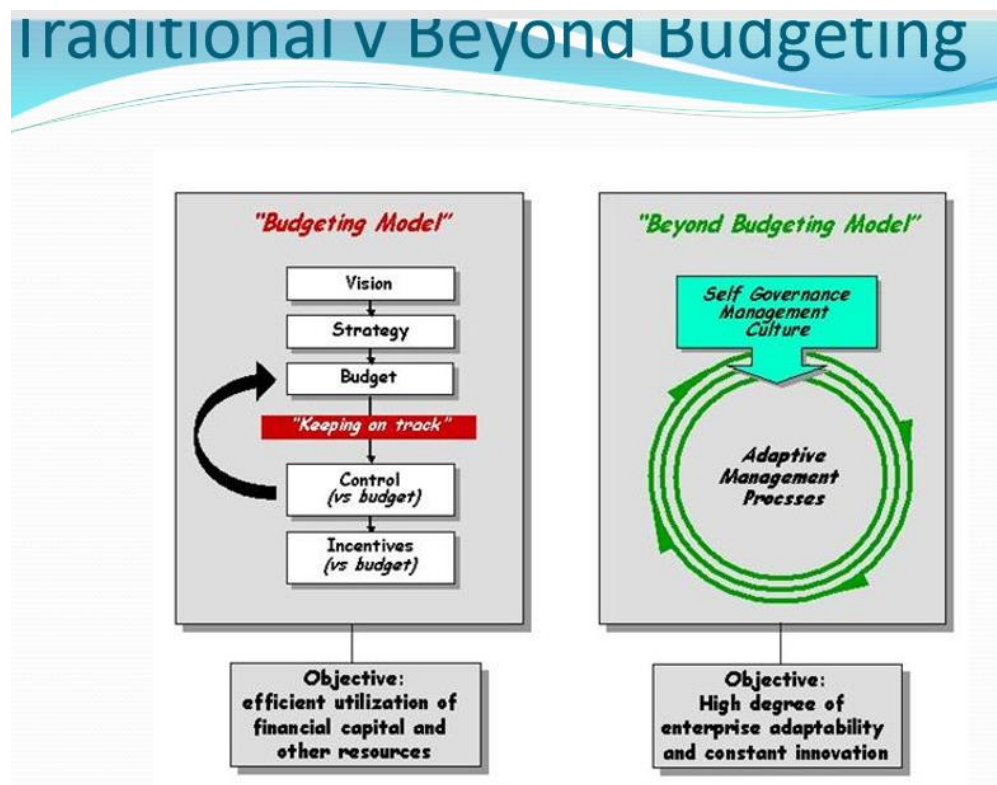
3.4 Flexible Budgeting

Biant, (2013a) described a flexible budget as a budget prepared to cover a range for a multiple level of activities within a business. Flexible budget is useful for sensitivity analysis and to manage risk and uncertainty. It is prepared at the beginning of the year for planning purpose and at the end of the year for performance evaluation.

Beyond budgeting

'Beyond Budgeting' means beyond command-and-control towards a management model that is more empowered and adaptive (fig 5&5a; BBRT, 2013).

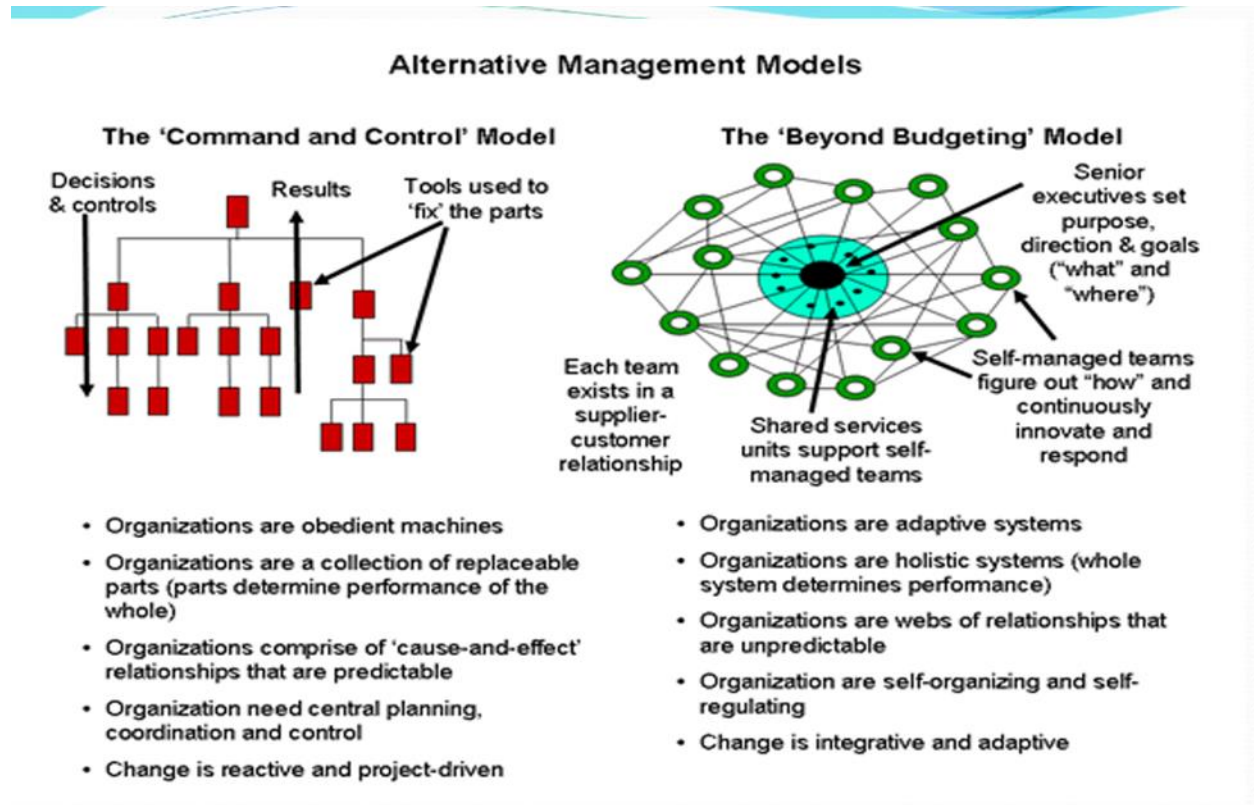
Fig 5 traditional budget v Beyond budgeting



(Biant, 2013, p. 1320)

Fig 5a The Alternative Budget Management Models

Beyond budgeting was designed to overcome some of the perceived drawbacks in TB, beyond budgeting is adaptive, it allows a decentralised management system rather than hierarchy and centralised leadership system.



(Biant, 2013, p. 1320)

The Beyond budgeting may combine the balanced scorecard with rolling forecasts and shareholder value models to overcome some of the traditional budget shortcomings (CIMA, 2008). Beyond budgeting utilise different tools including external benchmarks to evaluate managers' performance as (Biant, 2013a: Appendix 7). The organisation under the traditional budgeting, is an-obedient-machine. The focus is maximising shareholder value and fixing results but under beyond budgeting, the goal is for the organisation to adapt and endure; the focus is on fixing the whole system rather than individual parts that is each responsible holder is capable of organising and regulating itself; and change becomes a natural and adaptive process (BBRT, 2013).

4.1 Beyond conventional budgeting

Budget used to be a meaningful control but is perceived to have an adverse impact on enterprise success.

Many business analysts including General Electric Chairman Jack Welch and other CEOs in Europe challenged the idea of budget as a waste of time and a meaningless exercise that sucks the energy, time, fun and big dreams out of an organization (AMA, 2018). Others describes the traditional budgeting as a broken tool and is not relevant in today's volatile and dynamic business environment. Traditional budgeting deploys too many assumptions including the economic performance, assumptions about consumers behaviour, government policy, foreign exchange, interest rates etc. In addition, most of these factors are outside the control of the organisation. Fm-magazine, (2013) underpinned the problem by concluding that when budgeting assumptions turn out to be wrong, then the plans based on the assumptions are wrong.

Furthermore, Hope & Fraser, (1999) argued that budgeting is a barrier to companies in the digital and information age. They further pushed for managing without budgets in conclusion of their report on the next steps of the Beyond Budgeting Round Table--a pan-European research project. Besides, the Beyond Budgeting Round Table (BBRT) was established in 1997 in UK and thirty-three companies joined in 1998 to critically review growing dissatisfaction and frustration with traditional budgeting. Many companies across Europe, Asia, Africa and America have embraced BB (BBRT, 2013). Nonetheless for the model to be effective the budget planning and control must operate from the "bottom up" (Cvrkalj & Smolar , 2015).

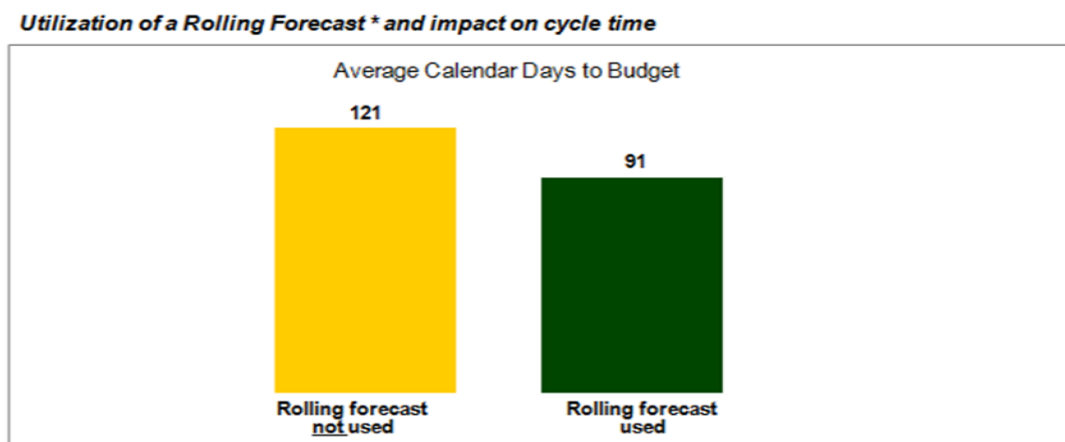
Thus, Beyond Budgeting is a radical approach, and for implementation, it will require the whole management team to subscribe to it according to Daum, (2002). It further requires specialist to implement it, it needs efficient controlling processes, and speed in planning process. Again, not

many company can deploy BB. Atrill & McLaney, (2015) claimed that beyond budgeting enable greater adaptability to any changing condition that confronts the organisation, it increases performance and increases motivation among staff. The beyond budgeting is a decentralised, inclusive and participative approach to business management. The decision making is devolved to the frontline managers according to Atrill & McLaney, (2015). Furthermore, BBRT, (2013) declared beyond budgeting as an adaptive system as it allows quick response to threats and opportunities, it promotes innovation, leads to value creation. It promotes good cooperate governance and ethical behaviour. Appendix 8 & 9, describes the differences between the traditional and beyond budgeting planning models.

Hope & Fraser, (1999) suggested ten principles of BB but other authors such BBRT, (2013); Daum, (2002) proposed twelfth principles that underpin the BB (Appendix 10). Fig 6 reveals that companies spend less number of days per year when Rolling forecast is used.

Fig 6 Companies using Rolling Forecast

Fast-planning companies utilize a Rolling Forecast to reduce efforts and improve quality in budgeting



(Biant, 2013, p. 1279)

The forecast is business driven not calendar driven, it provides expected outcome or early warning, there is frequency and time horizon and detail level. Also, forecast allows the dynamic allocation of resources (Appendix 11), there are KPIs to benchmark against performance, it allows for quick intervention because there is constant monitoring therefore, Biant, (2013) concluded that forecast is a call to action not a promise or a target.

4.2 Analyse the success of the beyond budgeting model since its introduction.

Stat Oil a case study

Statoil was formed on 18 September 1972, and the company reported \$61 Billion as turnover for the year 2017 (Statoil, 2017). Furthermore, (MarketLine, 2017) describe Statoil as primarily engaged in oil and gas exploration and production activities. The company operates in many regions of the World and has 20,539 employees. The company's key products and services include the following:

Crude oil, Natural gas NGL and other services etc. Statoil competes with BP Plc, Chevron Corporation Eni SpA etc. and is listed on Oslo Stock Exchange Ticker: STL and the New York Stock Exchange Ticker: STO. (see Appendix 12).

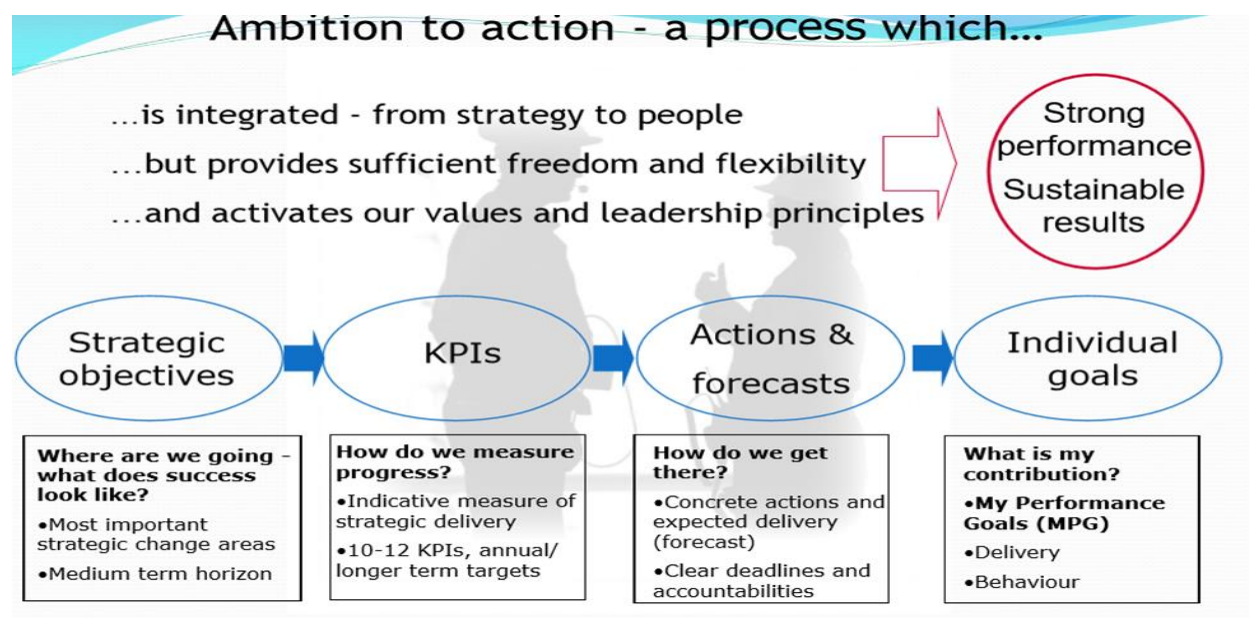
Stat oil adopted beyond budgeting was designed to overcome some of the perceived drawbacks in traditional budgeting was designed to overcome some of the perceived drawbacks in traditional budgeting. Beyond budgeting is adaptive, it allows a decentralised management system rather than hierarchy and centralised leadership system. B

eyond budgeting is adaptive, it allows a decentralised management system rather than hierarchy and centralised leadership system. and according to the CEO, Hedge Lund, Stat oil has model that

is designed to deal and respond to a rapid and turbulence change. The system allows them to reprioritise and respond quickly to fend off threats and seize opportunities. Stat oil benchmark themselves against competition (Appendix 13), they have a guide book called “ambition to action” this enable them to do the right thing at the right time or making sound business decision. More so, the budget model framework allows them to allocate resources on case-by-case basis. Again, the beyond budgeting enables the organisation to be forward looking and ready to act and lastly, there is a holistic assessment of performance and behaviour evaluation (Appendix 14).

Biant, (2013) elaborated further on Stat oil. Beyond budgeting needs staff that wants to take responsibility. The stat oil’s ambition-to-action process requires intergration of strategy to people and still provided freedom and flexibility. The evidence presented thus far by Stat oil supports the idea that Strategic objectives, KPIs, Actions & forecasts, and Individual goals are essential for beyond budgeting to be effective see fig 7.

Fig 7 Stat oil’s action to ambition



(Biant, 2013, p. 1335)

Furthermore, Stat oil clearly demonstrate their commitment to BB by declaring that there was more than 1100” Ambition to actions” across the company (Appendix 15).

4.3 Benefits of Beyond Budgeting to organizations

As explained in the introduction, it is clear that beyond budgeting tries to fix the shortcomings of traditional budgeting. The following section will briefly state the benefits. Beyond budgeting enables faster response, it demands innovative strategies, beyond budgeting leads to lower Costs and it can lead to both more loyal customers both internally and externally (Biant, 2013).

Dugdale & Lyne, (2006) proposed that budgets have changed significantly in the last 20 years. The increase use of forecasting is making budgeting to be more forward looking. Budgets are now better linked to strategic planning. Although forecasts are still viewed as a plan, nonetheless, the budgets will contain more detail. Another notable benefit of forecasting is that companies updated it more frequently. Dugdale & Lyne, (2006) concluded that the collection and storage of data has evolved due to new technology and this has impacted the budgeting process.

4.4 Reported drawbacks of the BB approach

Critics have also argued that the beyond budgeting model also has several serious drawbacks and CIMA, (2007) argued that without a budget, there is no overall framework of control which allows companies to plan, co-ordinate and control their activities.

- CIMA, 2007 argued that there is a lack of a detail road map that is revealing a company’s direction
- The budgeting culture may be very deeply entrenched in an organisation operation.

- Many organisations may not be able to adopt a decentralisation culture upon which success depends. Decentralisation may be more effective in banking and other financial institutions than other types of businesses.

In addition, 2005 survey by (Dugdale & Lyne, 2006) found that companies still used budgets. They discovered that managers largely viewed budgets and the budgeting process as indispensable, and the survey also revealed that most managers disagreed that budgets led to dysfunctional behaviour or that they provided little or no value.

5 Conclusion

Over the past 50 years, there has been a significant criticism of traditional budgeting, and yet it is still popular today. Traditional budgeting is still commonly used because it provides a good framework, it is part of the organisational culture and staff fully subscribe to it. In addition, the beyond budgeting attempts to fix some of the inherent problems in Traditional budgeting, nonetheless, not many companies can operate without a framework. If Stat oil experience is considered, Staff willing to take responsibilities is key to beyond budgeting succeeding. On the other hand, the availability of new technologies and the utilisation of forecasting is creating a better budgeting process (Dugdale & Lyne, 2006).

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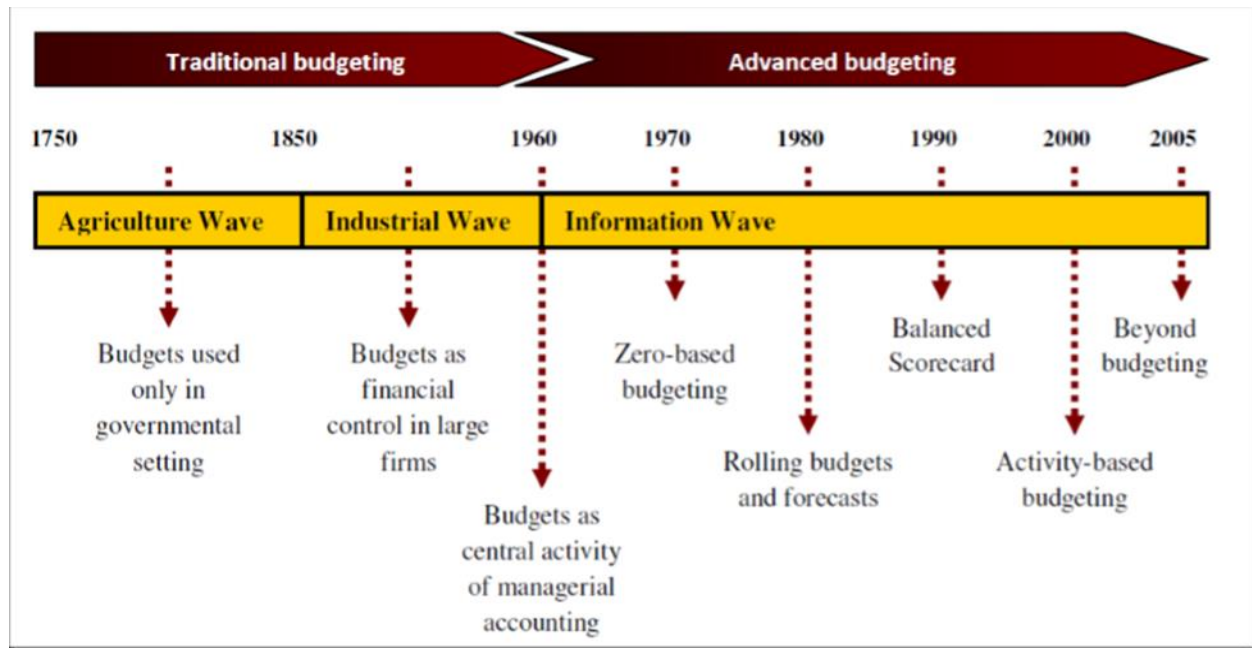
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Appendix

Appendix 1 Budgeting timeline



(Biant, 2013)

Appendix 1a Purpose of Budgets

Budgeting

The Purpose of Budgets

Meeting organization's objectives

Planning

Monitor & Control

Co-ordination

Evaluating Performance

Motivation for Managers

Management Contract

Communication

Provide a basis for authorising expenditure

Identify scarce resources

Delegation of responsibility

(Biant, 2013, p. 1369)

Appendix 2 Purpose of Budgets

Purposes of Budgeting

- Policy Direction
- The Budget as a Marketing tool
- Mutual Contracts
- Communication
- Motivation
- Monitoring of Service
- Resource Allocation
- Accountability Instrument

(Biant, 2013)

Appendix 3 Benefits of Budget

Benefits of budgets

1. Forces managers to do **planning**.
2. Realistic performance targets.
3. Basis for **controlling** what happens within the organisation.
4. Helps **coordinate** the activities of the various centres that make up the business.
5. **Communication** – managers exchange information on ideas, etc.
6. **Motivating** tool – if the process involves staff.

(Biant, 2013a)

Appendix 4 The Budget planning and control process



(Atrill & McLaney, 2015)

Appendix 5 Behavioural aspects of Budgeting

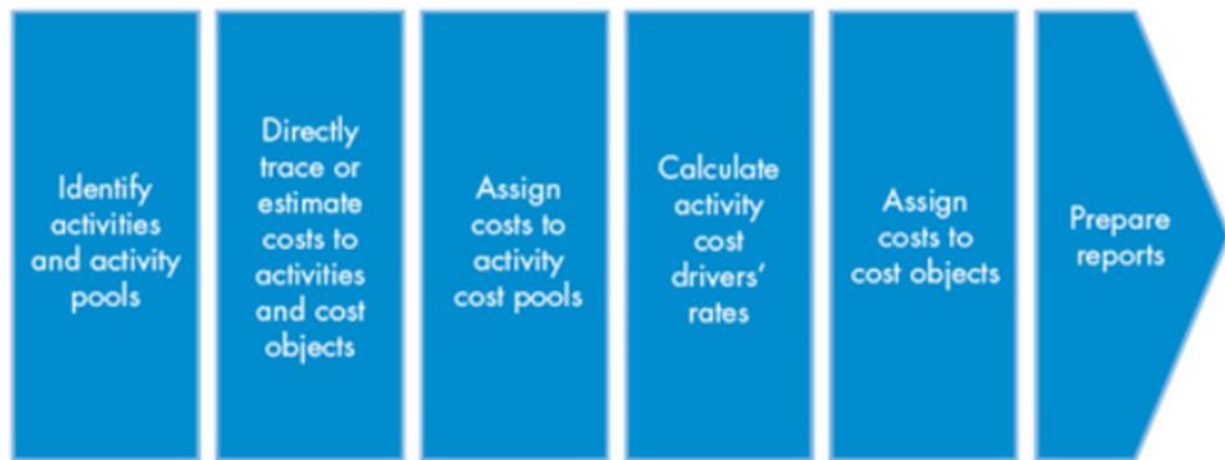
Behavioral aspects of budgeting

- To maintain supportive and cooperative relationships with staff.
- The use of punishment (authoritarian style) tends to encourage attempts to 'beat the system'.
- Padding the budget means overestimating costs and/or underestimating revenue.
- Participation in the budgetary process tends to result increased productivity and satisfaction.

(Biant, 2013a, pp. 9-103)

Appendix 6 The ABC process

The activity-based costing process:



(CGMA, 2013)

ABC is a modern alternative to absorption costing, it is allowing managers to better understand product and customer net profitability. This provides the business with better information to make value-based and therefore more effective decisions. (CGMA, 2013)

Appendix 7 Beyond Budgeting Tool

Beyond Budgeting Tools



- Balanced Scorecards*
- KPIs*
- Activity Based Management*
- Rolling Forecasts*
- “Real” costs v Standard cost*
- Relative (and continuous) improvement*
- External comparison & benchmarking*
- Delegation of Ownership of OUTCOMES not just INPUTS*
- Understand how the organisation is going to be successful*
- Understanding of people and motivation*

(Biant, 2013, p. 1349)

Appendix 8 Traditional Budgeting versus Beyond Budgeting

	Traditional Budgeting Management Model	Beyond Budgeting Management Model
Targets & rewards	Incremental targets Fixed incentives	Stretch goals Relative targets & rewards
Planning & controls	Fixed annual plans Variance controls	Continuous planning KPI's & rolling forecasts
Resource & coordination	Pre-allocated resources Central co-ordination	Resources on demand Dynamic coordination
Organisational culture	Central control Focus on managing numbers	Local control of goals/plans Focus on value creation

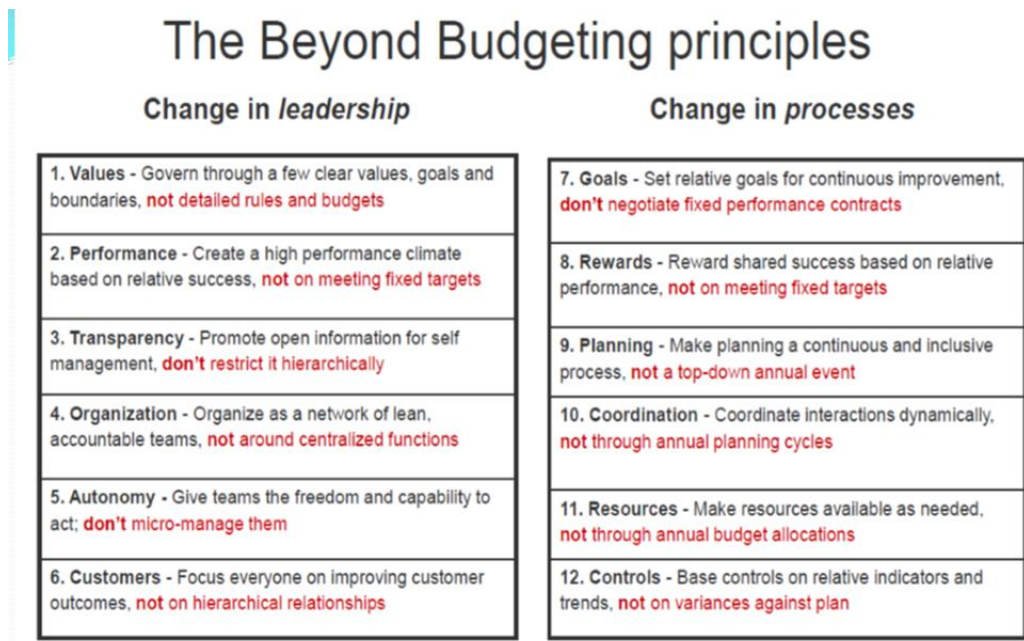
(kfknowledgebank, 2012)

Appendix 9 Contrasting models

Figure 5.0 – Contrasting mental models		
	Organization as an obedient machine	Organization as an adaptive system
Organization mental model	Organization is a machine made up of a collection of replaceable parts (parts determine the performance of the whole)	Organization is an adaptive system ; the system is holistic (whole system determines performance)
	Organizations comprise of 'cause-and-effect' relationships that are predictable	Organizations are webs of relationships that are unpredictable
		
Management mental model	Goal is to maximize shareholder value	Goal is to adapt and endure over long periods of time
	Focus is on 'ends' (targets); means are 'fixed' to meet 'ends' (results)	Focus is on 'means' (processes and people); ends take care of themselves
	Organizations need central planning, coordination and control	Organizations are self-organizing and self-regulating
	Economies of scale drive cost management	Economies of flow drive cost management
	Change is reactive and project-driven	Change is integrative and adaptive

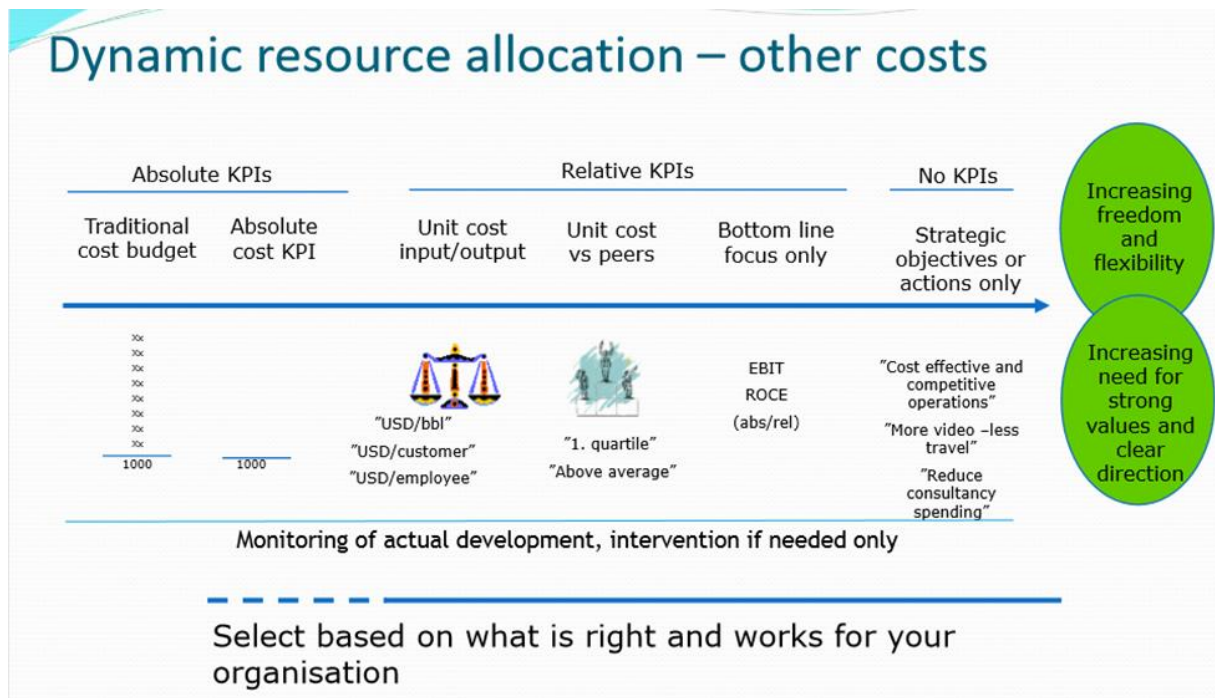
(BBRT, 1997)

Fig 10 The Beyond Budgeting Principles



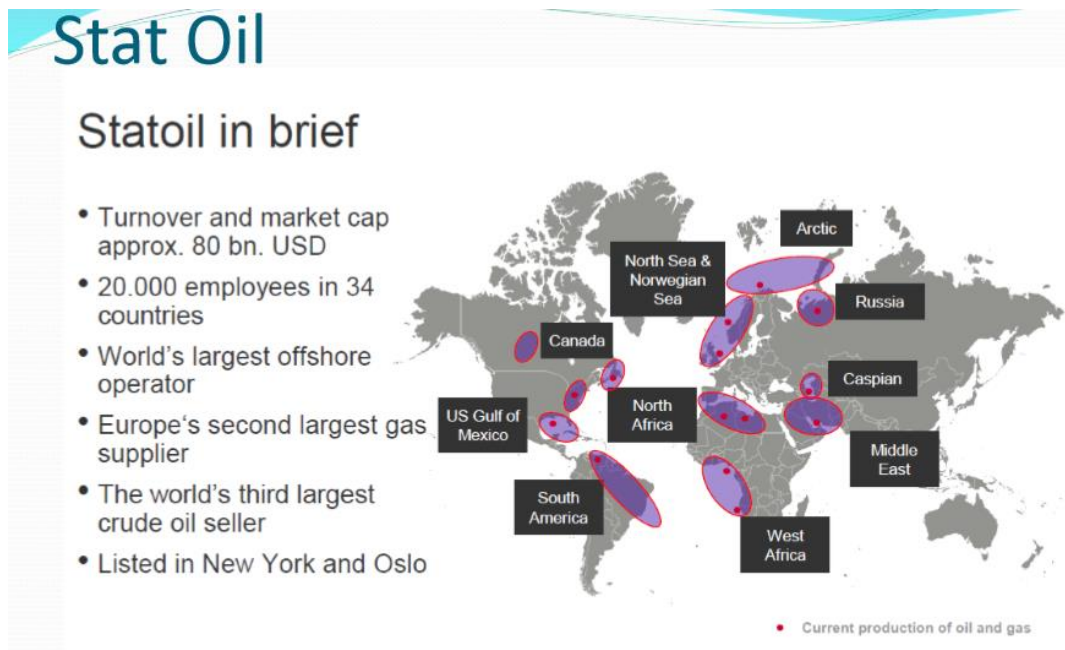
(Biant, 2013, p. 1332)

Appendix 11 Dynamic Resource Allocation



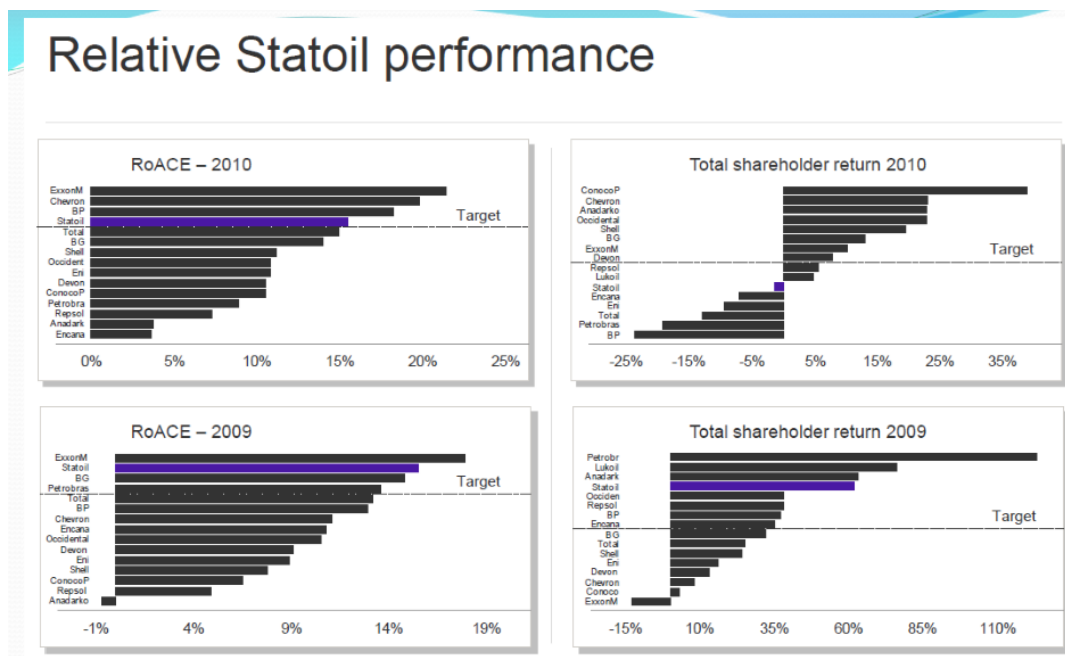
(Biant, 2013, p. 1342)

Appendix 12



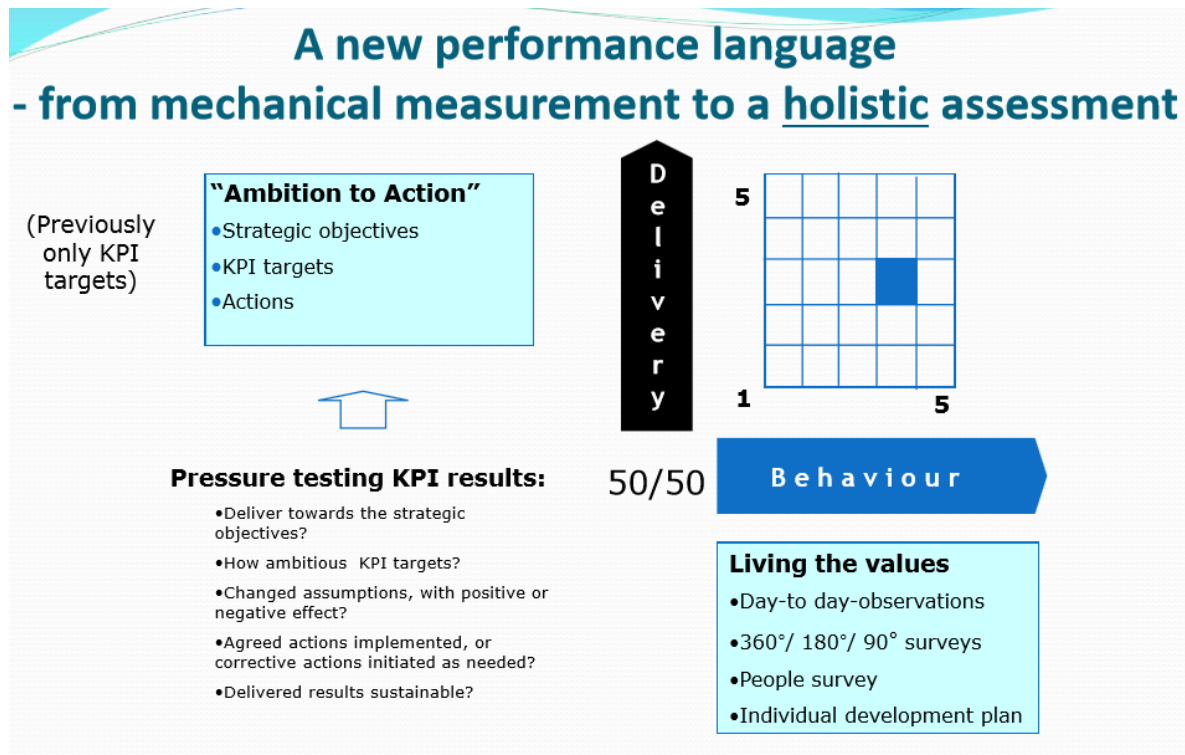
(Biant, 2013, p. 1325)

Appendix 13



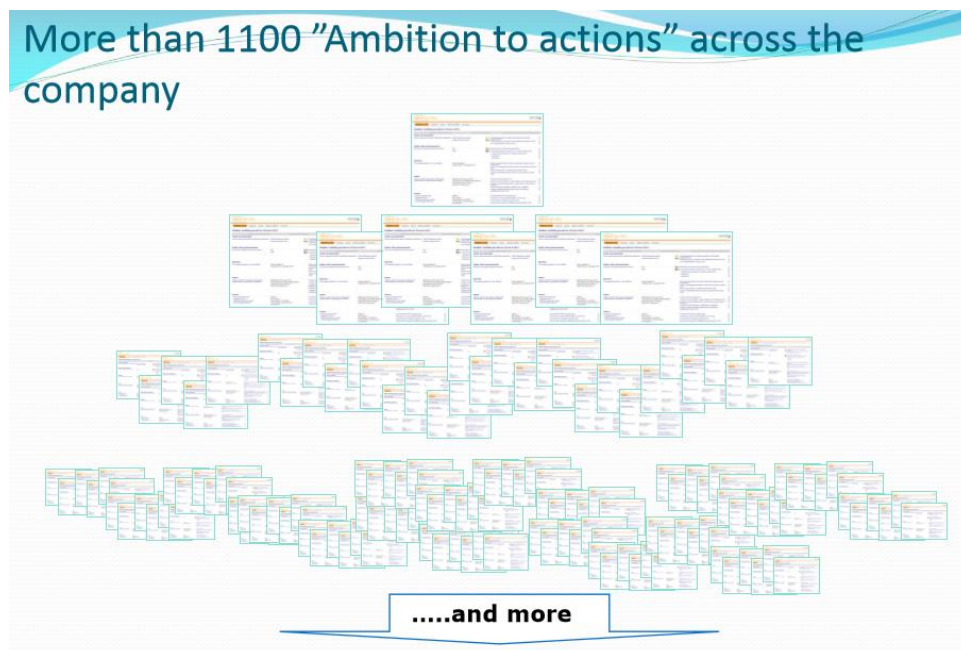
(Biant, 2013, p. 1343)

Appendix 14



(Biant, 2013, p. 1346)

Appendix 15



(Biant, 2013, p. 1337)