

BUDGETING ESSAY

UNIVERSITY: UNIVERSITY OF WALES TRINITY SAINT DAVID

MODULE NAME: MANAGEMENT ACCOUNTING

MODULE CODE: LCBB5002

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INTRODUCTION

Budgeting in a business context can be simply understood as a spending plan for the organisation (Frezatti et al. 2011). Primarily, it allocates costs from the income of the organisation. Research communicates that budgeting is imperative to ensure the success of an organisation in the dynamic business environment of today (Hartmann and Maas, 2010; Raghunandan et al. 2012). This is because it allows planning upfront for the most important issues that an organisation face or may face in the future (Field , 2011). Based on this, the objective of this paper is to critically assess the role of the budgeting process in taking optimal decisions within the changing environment. For this purpose, the paper will first outline the budgeting and its types briefly. This will be followed by the critical analysis of its role in decision making. The static, flexible and participative budgeting process will be evaluated to propose the effective option for this scenario.

BUDGETING AND ITS TYPES

As mentioned earlier, the budget can be simply considered as a spending plan, but also can be defined as a business plan for a short term (Atrill and McLaney, 2018). Typically, a budgeting activity involves the estimation of revenue as well as the expenditures of the organisation (Borghesi and Gaudenzi, 2013). Based on the market trends and the strategic plan of the organisation, the revenue is first estimated. This provides an estimated cash flow within the organisation. Based on this and considering the strategic priorities, the organisation can develop its expenditure plans (Horngren, Harrison and Oliver, 2012). In addition to this, an effective budgeting process had to consider several internal and external factors. It is important to put a higher emphasis on the budgeting process as it helps to pre-plan the possible challenges that a business can face and optimal resources can be reserved to deal with the challenge. Besides, it will also help an organisation to align its resources with its corporate objectives (Kaplan et al. 2016). Thus, budgeting can be argued as a critical requirement to survive in the dynamic business environment of today.

As far as the types of budgeting are considered, it is classified on various grounds. In terms of the financial estimations, this is typically divided into four major types. This includes incremental budgeting, activity-based budgeting, value proposition and zero-based budgeting (Grover, Kar and Vigneswara, 2018). In the incremental budgeting, the cost of the previous time-period of considered and additional expenses are added to get an estimate. For the activity-based budgeting, the actual cost of the activities required to achieve the target is calculated for an estimation (Field , 2011). Thirdly, for the value proposition technique, budgeting is aligned with the value created by the customers. Lastly, zero-based budgeting, which is one of the most commonly used types, starts with an assumption that cost at different heads is zero and that the estimation must be built from scratch (Borghesi and Gaudenzi, 2013). In another context, based on the applicability of the budgeting, it is also divided into static and flexible budgeting. A budgeting process typically based on the few assumptions. While the static budgeting does not allow the change in the numbers based on the external changes, the flexible budget allows altering the targets based on the changes (Field,

2011). Each type of budgeting has its advantages and disadvantages, which will be critically evaluated in the next section of this paper.

ROLE OF BUDGETING IN DECISION-MAKING

The recent literature indicates that budgeting exercise within an organisation is used for several purposes. This includes decision-making, planning and control at the top of the list (Vercellis, 2009). Specifically, considering the changing and highly dynamic business environment of today, budgeting is imperative to ensure the success of an organisation. Nevertheless, the effectiveness of budgeting exercise and its responsiveness to the practical situation is typically dependent on the assumptions, process and style of the budgeting process (Janssen, van der Voort and Wahyudi, 2017). For instance, if an organisation has simply based a budgeting exercise on its historical trends and has not considered the impact of external factors, the budget might not be effective and responsive to the external changes. When it comes to the decision-making by the managers, a budget is a tool that triggers a 'run-rate' required for the managers (Carbno, 2007). For instance, if a budget is based on a certain revenue and net profitability, the managers can take decisions to cut on expenditures or increase their marketing expenses in case of any possible changes in the expenses due to any external or internal challenge. Nevertheless, this is again dependent on the type of budgeting process. The following sections provide a critical account of different types and their suitability for the changing business environment.

STATIC AND FLEXIBLE BUDGETING

As argued earlier, a static budget is the one that does not allow changes in the initial assumptions made in the budgeting process. As argued by Yahya-Zadeh (2012) and Frew, Olson and Pelton (2009), a static budget is advantageous because it does not require frequent changes and thus, it aligns the management to achieve the initially decided targets. Similarly, it also helps to provide strong variance analysis, based on which, the effective decision about organisational strategy can be taken. In another context, Heyes and Kapur (2009) seem to disagree. According to the authors, the static budget loses essential flexibility, which is critical for modern organisations. An inflexibility within the organisation in terms of its financial resources would lead towards the wrong decisions by the managers. Besides, it may also support dysfunctional behaviour within the managers and their performance will also limit up to a certain point decided in the static budget. On the other hand, Oyadomari et al. (2018) negated this by arguing the static budgets are also helpful to ensure control as it reflects the actual performance against initial estimates. However, when it comes to business survival in the changing environment, flexible budgeting might be an effective option to select.

MERITS AND DEMERITS OF PARTICIPATIVE BUDGETING

A participative budgeting process is the one that involves lower levels of management. The proposals of expenses are shared by the lower and middle management and the higher management approves or disapproves the request (Beckett and Doamekpor, 2011). One of the major advantages

of this technique is to attain the maximum level of ownership. With this technique, the objective of meeting the budget directly involves the actual owners or controller of the costs (Syahputra, 2014). Thus, it helps to minimise the variance in the budget numbers. Additionally, it also helps to maintain a higher motivation level of the employees as they feel valued when they are involved in important decision-making (Cuganesan and Donovan, 2015). Nonetheless, as argued by Arsalan et al. (2018), if an organisation extensively relies on middle and lower management, there is a high likelihood of getting overestimated numbers. Normally, organisations link the performance of the managers with the achievement of budgets. In this scenario, the managers in the middle management may overestimate their expenses to get a high performance against the budget at the end (Zainuddin 2012; Zainuddin and Isa, 2019). At the same time, if higher management does not have experience and in-depth knowledge, it may get deceived, which will certainly influence the performance negatively (Cuganesan and Donovan, 2015). Thus, a participative budgeting exercise can be argued as effective, but it should only be used where the top management has an in-depth knowledge of the process on the ground. On the other hand, according to Atrill (2015, pp.195) the top-down budgeting approach is most preferable in practice than the participative or bottom up approach.

EFFECTIVE OPTIONS IN THE CHANGING ENVIRONMENTS

To support effective decision-making by the managers, the budgeting exercise may critically have to comply with the requirements of the contemporary markets. For instance, a static budgeting exercise might not be effective to respond to the varying business environment (Syahputra, 2014). For instance, taking an example of Samsung, the company would have a major revenue share through the sales of its flagship device of Galaxy Note 7. Nonetheless, due to higher safety concerns and poor market response, the company had to recall this device, while shutting down its production (Lopez, 2017; Loveridge et al. 2018). In this specific scenario, a flexible budgeting exercise would have allowed the company to prefer market reputation over targeted revenue and profitability. Similarly, several other examples can be quoted where flexible budget allows business organisations to adjust their focus based on the changing environment. In this scenario, it can be argued that flexible budgeting would be the most suitable approach to ensure optimal decision-making within an organisation in the changing environment of today. This can be combined with the participative budgeting exercise if top management had an in-depth knowledge of the processes and constraints at different departments.

CONCLUSION

The paper can be concluded by arguing that budgeting is undoubtedly a critical requirement for the continued success of an organisation. This allows the managers to take effective decisions and also helps to keep them on track. Nonetheless, the literature suggests that the degree of effectiveness vary depending upon the type and style of a budgeting exercise. Through a brief review in this paper, it can be argued that flexible budgeting could be a suitable option to improve responsiveness to the external and internal changes. Moreover, it also supports optimal decision-

making while eliminating the chance of any dysfunctional behaviour of the management. It provides flexibility to the management in terms of adapting to the external changes, which will certainly help an organisation to effectively respond to any internal and external challenge.

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