TRADITIONAL BUDGETING VERSUS BEYOND BUDGETING: A LITERATURE REVIEW

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Abstract: Budgets are an important part of the business environment since 1920 and are considered to be the key drivers and evaluators of managerial performance; and the key elements for planning and control. Budgets are the most powerful tool for management control; they can play an essential role in the organization’s power politics because it can increase the power and authority of top management and limit the autonomy of lower-level managers. Besides its advantages traditional budgeting presents disadvantages also. In recent years criticism towards traditional budgeting has increased. The basis of this criticism is that traditional budgeting is a relic of the past; it prevents reactions to changes in the market, it cannot keep up with the changes and requirements of today’s business world and it isn’t useful for business management. In order to eliminate criticism researchers and practitioners have developed more systematic and alternative concepts of budgeting that suits better for the needs of the modern business environment. Beyond budgeting, better budgeting, rolling forecasts, activity-based budgeting are the main alternatives developed in the last years. From the mentioned alternatives this article examines only beyond budgeting. Our paper discusses how budgeting has evolved into its current state, before examining why this universal technique has come under such heavy criticism of late. The paper is a literature analysis, it contributes to the existing managerial accounting literature and it is structured as follows. In the first part the background and evolution of budgeting is presented, followed by the analysis of related theories in traditional budgeting, emphasizing both the advantages and disadvantages of traditional budgeting. The second part of the paper continues with the discussion about alternative budgeting methods highlighting pros and cons of alternative methods, especially beyond budgeting. In the third part conducted surveys and studies are analyzed in order to establish whether traditional or alternative budgeting methods are better and have a positive impact on businesses; or which has more practical usefulness. The final part provides conclusions and discussions for future research.

Keywords: budgeting, traditional budgeting methods, beyond budgeting.

JEL classification: M41, M19

1. Introduction

Budgets were born in the 1920s in order to help managers control costs and cash flows. By the 1960s, they had become fixed performance contracts between company superiors and subordinates. They were primarily concerned with estimating future income and expenditures and in time became the key drivers and evaluators of managerial performance (CIMA, 2007; Goode and Malik, 2011). Furthermore, budgets are considered
to be key elements for a company's planning and control; and they are used to help implement companies' strategies (Rickards, 2006). Every company has plans and objectives derived from the company's long-term strategy. The purpose of budgeting is to give those targets and plans financial values, making the progress easily measurable and to transform the strategic ideas into understandable operative actions (Hanninen, 2013). In time, drawbacks of traditional budgeting have been identified. Traditional budgeting methods are time consuming and costly; rarely focus on strategy and are often contradictory; add little value; focus on cost reduction rather than value creation; strengthen vertical command and control. Although traditional budgets have evolved over the years it is considered that they couldn't face the changes in the economic and business environment, they must be reshaped; alternative budgeting methods must be created.

Beyond Budgeting has been proposed as an influential idea that will reinvigorate management accounting contribution in business operation and performance (Goode and Malik, 2011). Hope and Fraser (2003) consider that the budgeting system should be eradicated because the environment is now so complex and competitive that budgeting in its existing form is no longer useful for businesses. Dissatisfaction with traditional budgets is growing in the business world and beyond budgeting has been suggested as a method to reinvigorate the managerial contribution of management accounting.

This article discusses how budgeting has evolved into its current state, before examining why this universal technique has come under such heavy criticism of late. The paper is a literature analysis, it contributes to the existing managerial accounting literature and it is structured as follows. In the first part the background and evolution of budgeting is presented, followed by the analysis of related theories in traditional budgeting, emphasizing both the advantages and disadvantages of traditional budgeting. The second part of the paper continues with the discussion about alternative budgeting methods highlighting pros and cons of alternative methods, especially beyond budgeting. In the third part conducted surveys and studies are analyzed in order to establish whether traditional or alternative budgeting methods are better and have a positive impact on businesses; which have more practical usefulness. The final part provides conclusions and discussions for future research.

2. Research methodology
According to Lukka and Mouritsen (2002) in order to create good research in the field of managerial accounting, in order to generate good and relevant knowledge there is a need for theory, testing and rigour. In this article we focus on theory. Our intention is to lecture in the field of managerial accounting, to understand the concept of budgeting, to present both traditional and alternative budgeting methods in order to address further research questions.

This paper is a result of literature analysis, it is a literature review. Researchers (Webster and Watson, 2002; Onwuegbuzie, Leech and Collins, 2012) consider that literature review represents the most important step of the research process in qualitative, quantitative and mixed research studies. Moreover, they consider that a sophisticated literature review is the foundation and inspiration for substantial and useful research. Literature review allows gathering information from a broad range of sources; permits surveying the state of knowledge on a particular topic; examining what has been undertaken and what needs to be undertaken; permits identifying relationships between theories, concepts and practice; identifying the main research methodologies that have been used; identifying strengths and weaknesses of the various research approaches that have been used by other researchers (Onwuegbuzie, Leech and Collins, 2012).
We intend to synthesize the existing literature on budgeting; to pay special attention to traditional and alternative budgeting methods presenting both its advantages and disadvantages; to interpret and connect our findings with their practical usefulness. In this process we use grounded theory and comparative analysis.

3. The background of traditional budgeting

Budgeting is considered to be one of the most important, successful and useful tool or technique used in managerial accounting (Pietrzak, 2013). Nowadays almost every organization relies heavily on budgets and budgetary systems to achieve strategic goals and it can reap handsome rewards if they are properly understood and implemented (Raghunandan, Ramgulam and Raghunandan-Mohammed, 2012).

According to the literature (Campbell, 1985; Horngren, Datar and Rajan, 2012) a traditional budget is a quantitative expression of a proposed plan of action by management for a specified period and an aid to coordinate what needs to be done to complement that plan. Its main purpose is the achievement of objectives and direct managerial effort through planning, coordinating, measuring and rewarding. The budget serves as a financial plan in support of a specified target. Moreover, the process of budgeting implies setting strategic goals and objectives and developing forecasts for revenues, costs, production, cash flows and other important factors. Horvath and Sauter (2004) considers that the corporate budget was designed to serve three main purposes: (1) coordinate the organization’s financial activities and picture; (2) communicate financial expectations and (3) motivate managers to act in the company’s interest.

In achieving the main objectives and purposes Raghunandan, Ramgulam and Raghunandan-Mohammed (2012) considers that in the budgeting process there are both technical and behavioural aspects that must be taken in consideration. The recognition of both technical and behavioural aspects of budgeting is essential if goals and objectives are to be achieved. While the technical component of budgeting refers to mathematical calculations of projected costs and expenses, the behavioural component focuses on the ability to achieve the technical aspect of budgeting with the use of people. The behavioural and social aspects of budgeting are an integral part of the budgeting process and should not be separated from the technical side. The management style, culture and attitude towards employees will determine the approach to budgeting within each organization.

In general, the budgeting process is a “back-and-forth movement between top and lower management” (Hanninen, 2013:18). Based on this there are three main approaches (Raghunandan, Ramgulam and Raghunandan-Mohammed, 2012) that can be employed when developing budgets: (1) top-down approach or imposed budget – where top management decides on the budget and lower level management is responsible for the execution; (2) bottom-up approach or participative budget – where the lower level management creates their own budget and all various sub-unit budgets are then consolidated to corporate level; (3) negotiated budget – adopts both the imposed and participative styles of budgeting and creates an environment where everybody is responsible for the prepared budget. While the imposed budget assumes an autocratic style of leadership, the participative budget is supportive of the democratic style of leadership. All in all the approach chosen when budgeting depends on the leadership style and the nature of every organization. Moreover, active participation of managers and employees to the budgeting process is essential, commitment is vital to the effectiveness of the process.

Budgets represents formalized plans of management’s objectives, they serve as a guide in the implementation of the established strategies. Usually the approaches of traditional budgeting are numerous especially because there are no regulations stipulating how and which form of the budget should be used or applied. Still, there are some influencing factors that must be taken into account like organizational structure, the nature and
complexity of internal operations, the management philosophy (Hanninen, 2013). The most common budgeting method is to use previous year’s figures adjusted to the new year with the management’s assumptions and goals. This method suits better for companies whose operations are relatively stable. Nevertheless, this method is considered to be the worst possible method because budget figures are forced to fit the overall objectives of the company (Bunce, Fraser and Woodcock, 1995).

Zero-based budgeting (ZBB) is a better solution for history based budgeting. ZBB does not start from the previous year’s budget level; the budgeting process starts from zero. The existing operations and managerial activities are properly identified and evaluated; the operation and activities must be justified on the basis of its usefulness and its need to the company. This budgeting process requires the managers to have an updated view of their plans and consider the most suitable method to achieve their objectives. Usually this process is not an easy one, it requires an in-depth analysis of the company’s operation. That is why ZBB is not a very effective budgeting method.

In all cases the connection between budgeting and strategy is essential. If the budget is not linked with the strategy the budgeted objectives may be distorted, the operation might evolve to wrong direction.

The budgeting process, the traditional budgeting methods presents both advantages and disadvantages. The main advantages of traditional budgeting are planning, control and performance management. According to Hanninen (2013) the budget is the most powerful tool for management control. It can play an essential role in the organization’s power politics because it can increase the power and authority of top management and limit the autonomy of lower-level managers. Moreover, management control can’t exist without budgetary control. Control starts by following the results closely; then the differences between budget and the actual figures are analysed. The comparison should help managers to understand the current situation and to decide what to do in the future, whether to keep the current direction or try to change the course. Through control managers are kept focus on the key issues of the company’s actions and objectives.

Another major advantage of budgeting is that budgets can also be used to support performance management. If the budget has been properly prepared it gives the management detailed information about the next fiscal year; it gives the possibility to set objectives easier; becomes an important tool is the decision making process.

Besides its advantages traditional budgeting presents disadvantages also. In recent years the criticism towards traditional budgeting has increased. The basis of this criticism is that traditional budgeting is a relic of the past (Hanninen, 2013); it prevents reactions to changes in the market, it cannot keep up with the changes and requirements of today’s business world and it isn’t useful for business management (Neely, Sutcliff and Heyns, 2001; Hansen, Otley and Van Der Stede, 2003; Horvath and Sauter, 2004; Pietrzak, 2013; Zeller and Metzger, 2013).

In 2001 Neely, Sutcliff and Heyns presented the most cited weaknesses of traditional budgeting. They identified the following disadvantages: budgets are time consuming and costly to put together; budgets are rarely strategically focused and often contradictory; they add little value, concentrate on cost reduction and not value creation; they are developed and updated infrequently, usually annually; budgets are based on unsupported assumptions and guess-work; they strengthen vertical command and control; reinforce departmental barriers rather than encourage knowledge sharing and makes people feel under-valued. Similar ideas were found by Higgins (2005) and by Libby and Lindsay (2010). In their research they found out that traditional budgeting is time consuming and costly; it detects problems slowly and quickly becomes out of date; it does not reflect the strategy; leads to unreliable performance evaluation and promotes budget garning.
The presented problems of traditional budgeting were summed up by Hansen (2003) to three categories: time, process and people related. Hansen (2003) considers that the time related issue is the most problematic disadvantage because budgeting is a long and heavy process, usually it takes four or five months to make it, and it takes up to 30% of a managers' time which can be very costly. Considering the used resources it adds only a little value to the company. Moreover, people related aspects can be problematic also. Budgeting creates dysfunctional behaviour, complicates cooperation within the organization when it is used for performance measurement and personal target setting, when objectives and goals are set too low or to high.

To eliminate the criticism and disadvantages of traditional budgeting researchers (Pietrzak, 2013) consider that there is a need for alternative solutions and budgeting methods designed to adapt to the new environmental conditions, market developments, technical progress, growing competition, customer orientation.

4. Alternative budgeting methods – beyond budgeting

Over the years it has claimed that traditional budgeting has lost relevance with the modern business environment and is no longer satisfying the needs of managers (Rickards, 2006; Goode and Malik, 2011). As a response to that researchers and practitioners have developed alternative budgeting methods that suits better for the needs of the modern business world. Beyond budgeting, better budgeting, rolling forecasts, activity-based budgeting are the main alternatives developed in the last few years.

Beyond budgeting (BB) has been proposed an influential idea that will reinvigorate managerial accounting contribution in business operation and performance. The name – beyond budgeting – is misleading. The purpose is not to get rid of budgets. The purpose is to create more agile and human organizations. This requires significant changes in the existing management models; reconsideration of the existing budgeting processes and the budgeting mind set.

The beyond budgeting concept is attributed to Jeremy Hope and Robin Fraser. They are considered to be the parents of both beyond budgeting and the Beyond Budgeting Round Table (BBRT). The BBRT was set up in the late 1997 in response to growing dissatisfaction, indeed frustration, with traditional budgeting. BBRT is a member-based network of organizations focused on improving planning, forecasting and control, and ultimately overall performance. Although the BBRT's origins are in the United Kingdom, members have joined from many countries, such as France, Germany, Belgium, Holland, Norway, South Africa, Sweden, Switzerland and the United States. BBRT helps organizations implement global best practices in planning and control; disseminates front - line implementation experience and identifies the keys to success; continuously improves adaptive planning and control to increase profit.

Beyond budgeting is a set of guiding principles that, if followed, will enable an organization to manage its performance and decentralize its decision making process without the need for traditional budgets. Its purpose is to enable the organization to meet the success factors of the information economy. BB is a specific idea which regards the abolition of the traditional budget process as the trigger for improving management control within organizations by a fundamental re-examination of how they might be managed better (CIMA, 2007).

Hope (2003) considers that compared with the traditional budgeting beyond budgeting has two fundamental differences. First, it is a more adaptive way of managing. In place of fixed annual plans and budgets that tie managers to predetermined actions, targets are reviewed regularly and based on stretch goals linked to performance against world-class benchmarks, peers, competitors and prior periods. Second, BB enables a more decentralized way of managing. In place of the traditional hierarchy and centralized
leadership, it enables decision-making and performance accountability to be devolved to line managers and creates a self-managed working environment and a culture of personal responsibility. This leads to increased motivation, higher productivity and better customer service. Individually these two main features can produce significant benefits, but it is in their combination where its real strength lies.

Hansen (2011) shares similar ideas. He believes that the transition to beyond budgeting is a two-phased process. The first step is to replace traditional budgeting with the beyond budgeting concept. The second step is to decentralize the whole organization and increase the independence of lower level managers.

In order to abolish traditional budgeting changes in the internal processes; various principals for reforming companies planning and control systems are needed. This changes and leadership principles can be summed up to six points (Rickards, 2006; Hanninen, 2013). These points are: target setting; rewarding people; action planning; managing resources; coordinating actions; measuring and controlling performance. In BB targets are no longer set as fixed financial figures; they are based on high level key performance indicators, which usually are both financial and non-financial targets. Goals are set to maximize short and medium term potential, objectives are not annual, they might have different time periods. All this enables the target setting to be much faster. Performance measurement and rewards are major issues in beyond budgeting. In BB rewards are based on relative performance not fixed annual targets, in this way the best performers are recognized and rewarded. Under BB action planning is changing. Managers are not trying to achieve fixed objectives but they are responsible to take actions in order to maximize customer and shareholder value; they can delegate responsibility for strategy review to business units or front line teams. In this way teams can create value, they can respond to changes and can anticipate business threats and opportunities. Moreover, resource management is better; managers could decide which operational resources are needed in the internal processes; they keep control on expenses because the coordination of activities is based on current market demand. Finally, under BB performance management and control supposes a greater focus on trends and forecast. In order to have a better view of the future rolling forecasting is used to give a clear picture of the key indicators used (Hope and Fraser, 2003; CIMA, 2007). All in all, to a successful implementation there must be a governance framework with clear priorities and boundaries in every organization. Moreover, managers should consider carefully the degree of decentralization; they must give freedom to front line teams to take decisions within agreed parameters. And last but not least, there is a need for trust and openness, collaboration and communication at all levels of the organization (Hope and Fraser, 2003; CIMA, 2007).

As we can see beyond budgeting appears to have many advantages over traditional systems but it is not without criticism of its own. According to CIMA (2007) having no budget creates various problems. A business will have no framework for planning, coordinating and controlling its activities. The business can lose direction without detailed plans of its current position and future goals. Moreover, a drastic culture change can leave employees feeling disillusion and the decentralized structure may be impractical for some organizations (Goode and Malik, 2011).

5. Traditional budgeting versus beyond budgeting: what does the practice say?

Budgeting was an interesting topic among researchers and practitioners. Over the years studies were made in order to decide whether traditional or alternative budgeting methods are better and have a positive impact on businesses. Although traditional budgeting has met intense criticism it still is universally used, it seems that most companies do not have plans of abandoning it. The literature (Hansen, Otley
considered that the dissatisfaction with budgeting in practice is occurring on two fronts: those that wish to abandon traditional budgeting and those that wish to improve it. Budgets are used for planning, coordination and evaluation of activities, motivation and evaluation of staff performance, for supporting the internal control system of organizations. The percentage of companies that use it is very high, around 90% in developed countries and developing countries (Goode and Malik, 2011; Pietrzak, 2013).

In 2006 Dugdale and Lyne surveyed financial and non-financial managers in 40 UK companies and found out that budgeting is alive and well. The majority of surveyed managers confirmed the importance of budgets, they admitted that budgets are used for planning, control, performance measurement, coordination and communication. Moreover, the managers disagreed that budgets led to dysfunctional behaviour or provides little or no value. Indeed, more than half of the respondents reported some form of change in the past years but these changes didn’t decline in importance the traditional budgeting methods; didn’t led to beyond budgeting. In fact, respondents reported more sophisticated traditional budgeting and tighter financial controls.

Libby and Lindsay (2010) conducted a study among managers working in medium to large-sized organization, members of CMA Canada and IMA (Institute of Management Accounting) in USA. The majority of responding organizations were from the manufacturing sector, followed by the service sector. But stand-alone companies or divisions of larger companies were both represented in the study. The majority of the respondents (80% of the Canadian and 77% of the US sample) indicated that budgets were used for control purposes in their organizations and they were not planning to abandon the use of traditional budgeting in the near future. Only 5% indicated they were considering abandon and only 1% indicated that there were definitely planning to abandon budgeting in the next two years. As for the changes in the budgeting systems the majority planned to change or adapt their budgeting system. The results suggest that traditional budgeting will not soon be eliminated because they obtain considerable value, they were only planning to improve their existing budgeting systems not abandon them.

As for the use of beyond budgeting model in practice the literature presents a mixed picture. Hope and Fraser (2003) reported that a Skandinavian Bank abolished all forms of traditional budgeting and since then it has grown into the largest bank in Skandinavia. The bank used a decentralized structure to enable each branch to run as an independent profit centre.

Rickards (2006) presents a report about well-known companies in various stages of successfully integrating beyond budgeting into their management processes. Companies like Borealis (a leading European petrochemical manufacturer), Unilever (health and hygiene), Rhodia (a French chemical concern), German Railways, BASF-IT Services (IT services) are the examples of beyond budgeting successful implementation.

Despite these examples beyond budgeting is still in the early stage of development and use (Goode and Malik, 2011). In 2009 the Chartered Institute of Management Accountants (CIMA) conducted a study about current and intended usage of managerial accounting tools, split into operational, managerial and strategic groups. The majority of the survey respondents were from UK (61%), while the rest were from all over the world (rest of Europe, Asia, Africa, Australia, America and Middle East). The manufacturing sector, financial services, professional services, public sector, education, retail and trade, IT and telecommunications and the hospitality industry was represented in the survey.

Survey evidence shows that organizations use a range of budgeting tools. The smallest companies make the least use of budgeting tools, they use less sophisticated budgeting techniques as owners have greater control and oversight of expenditure. As for the used budgeting tools, beyond budgeting seems to be the least popular. While the most popular tools are zero based budgets, rolling forecast, cash forecast and financial year forecast.
Analyzing the presented surveys our conclusion is that the literature shows a mixed picture of budgeting. We can state that budgeting stands at a crossroads. Every organization has unique requirements for their financial planning. It is not a simple choice to choose between traditional or alternative budgeting methods. Beyond budgeting could easily discarded as a management tool and has no chance against traditional budgeting on long term. But if the beyond budgeting concept is examined objectively it could reveal much better practices compared to traditional budgeting methods (Hanninen, 2013).

6. Conclusions
Budgeting is a major management activity, it’s major objective is to support management in strategy implementation, in planning and controlling activities. The changes in the economic environment and business processes led to evolutions in budgeting. From the initial cash budgets and future income and expenditures estimation budgets evolved to more modern techniques such as zero based budgeting, activity based budgeting or beyond budgeting. The alternative budgeting methods gained popularity as they proposed solutions to traditional budgeting’s perceived problems. 

Eventhough several advantages were attributed to beyond budgeting the movement is still in his early stages of development. The concept requires further research, development and practical implementation before a real breakthrough is managerial accounting is achieved.

Although traditional budgeting is often inappropriate for the current environment is still very popular among organizations and will not soon be eliminated. Every organization sets specific targets and objectives and the management style, culture and attitude towards employees will determine the approach of budgeting within each organization. Moreover, management could find it difficult to totally abandon budgeting as it is embedded in his business culture. We consider that traditional budgeting methods require refreshing and revitalizing in the near future. Beyond budgeting calls for a basic change, it supposes fundamentally transforming a company’s management model, needs a decentralised way of managing. And in many cases organizations are not ready yet for this kind of changes. We believe that beyond budgeting would reinvigorate management accounting contribution in business operations and performance in the future.

References


