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Ildikó Réka CARDOȘ
Faculty of Economics and Business Administration,
Babeş-Bolyai University, Cluj-Napoca

NEW TRENDS IN BUDGETING – A LITERATURE REVIEW

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Abstract

Budgeting is universally used all over the world. Budgets are the most powerful tool for management control, they are the key drivers and evaluators of managerial performance. However, in recent years criticism towards traditional budgeting has been notably increased. Researchers consider that traditional budgeting is a relic of the past; it cannot keep up with the changes and requirements of today's business world. As an answer, alternative budgeting concepts were developed, such as beyond budgeting, forecasting or activity-based budgeting. Our paper is a literature analysis. First, the background and evolution of budgeting is presented, emphasizing both the advantages and disadvantages of traditional budgeting. Second, we continue the discussion about alternative budgeting methods highlighting their pros and cons. Third, 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.

1. Introduction

Budgeting is the cornerstone of the management control process in nearly all organizations (Hansen et al, 2003) and is traditionally described as a common accounting tool that organizations use for implementing strategies (Ostergren& Stensaker, 2011). 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). However, traditional budgets are seen by practitioners of being incapable of meeting the demands of the competitive environment and are heavily criticized for impeding efficient resource allocation and encouraging budget games (de Waal et al, 2011). As a response to that new approaches to management control and budgeting appeared. Activity based budgeting, rolling budgets and forecasts, beyond budgeting appear to be closely connected to organizations and address the shortcomings of traditional budgeting practices.

In this article we explore the changes in the budgeting process. We discuss how budgeting has evolved into its current state, before examining why this universal technique has come under such heavy criticism. First, we try to present the researchers' opinions regarding traditional and alternative budgeting methods. Second we intend to show the practitioners' concerns with budgeting problems. We would like to find out whether traditional or advanced budgeting methods and alternatives are used in companies all over the world.

2. Research methodology

This article is the result of literature studies in which techniques like critical analysis, generalization of other authors' views, opinions and conclusion have been used. Our paper contributes to the existing management and managerial accounting literature and is structured as follows. First, the background and evolution of budgeting is presented, emphasizing both the advantages and disadvantages of traditional budgeting. Second, we continue the discussion about alternative budgeting methods highlighting their pros and cons. Third, 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.

3. The evolution of traditional budgeting

According to Horngren et al. (2012) cited by Zeller& Metzger (2013, p.2) 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".

A budget is expressed in financial terms; it is a financial reflection of the organization's annual operating plan. The budgeting process implies setting strategic goals and objectives; developing forecasts for revenues, costs, production, cash flows and other important factors. Moreover, it is a process in which the budget is determined in several rounds of dialogue between higher and lower management levels. Over the year the organization checks regularly if the targets are reached (de Waal et al., 2011).

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, factors like organizational structure, the nature and complexity of internal operations, the management philosophy (Hanninen, 2013) must be taken into account when budgeting.

De Waal et al. (2011) identify four main advantages associated with traditional budgeting. First, budgeting compels planning by helping managers to set realistic goals, it requires them to plan specific actions to be able to meet their stated goals. Making a budget requires managers to think ahead and to ask "what-if" questions. Second, budgeting promotes coordination and communication. Defining and agreeing upon a budget requires coordinating all the organization's activities and it also requires communication about the various activities and how these interact and influence the organization's results. Third, budgeting aids performance evaluation. 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. Fourth, budgeting motivates employees to achieve certain goals and to strive for the best.

Although budgeting is an important control system for most organizations many managers are dissatisfied with their current system and are considering changes (Hansen, 2011). Over the years criticism towards traditional budgeting has increased. The basis of this criticism is that traditional budgeting is considered as a relic of the past (Hanninen, 2013); it cannot keep up with the changes and requirements of today's business world and highly competitive environment (Libby& Murray, 2007); impede the allocation of resources to their best uses and encourage myopic decision making and other dysfunctional budget games (Hansen et al., 2003; de Waal et al., 2011; Pietrzak, 2013).

Moreover, the literature (Hansen et al., 2003; Neely et al., 2003; de Waal et al., 2011; Pietrzak, 2013) identified a list of the 12 most cited weakness of traditional budgeting. According to them budgets are time consuming and costly to put together; they constrain responsiveness and are often a barrier to change; 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 undervalued.

Overall, the predominant theme in the literature is that planning and budgeting processes used in organizations are failing to deliver results; they add limited value to the business management; they are too time consuming and costly to undertake; they encourage internal politics rather than driving business performance. Collectively, these weaknesses lead towards business underperformance.

Considering these limitations and criticism the literature considers that there is a need for alternative budgeting methods and for new solutions designed to allow companies to adapt to new environmental conditions. In the next section we focus on the new alternatives in budgeting.

4. New trends in budgeting: activity-based budgeting, rolling budgets and forecasts, beyond budgeting

Despite the widespread use of traditional budgeting, academics consider that it is far from perfect, it has lost relevance with the modern business environment and is no longer satisfying the needs of managers (Rickards, 2006; Goode&Malik, 2011).

As a response the literature (McNally, 2002; Banovic, 2005) proposed two distinct approaches to address the shortcomings of traditional budgeting practices:

- Better budgeting approach – presumes improving the budgeting process by focusing on the planning problems with budgeting;
- Beyond budgeting approach – supposes radical changes to the budgeting process and it is concentrated on performance evaluation problems with budgeting.

Both approaches consider that traditional budgeting is fundamentally mismatched to today's rapidly changing and uncertain environment and the existing alternative or advanced budgeting models address the limitations of traditional budgeting.

In the following sections we are going to address the most popular alternative budgeting models in more detail. Activity-based budgeting and rolling budgets and forecasts are approaches and techniques that can aid improved budgeting and planning processes, while beyond budgeting focuses reinvigorates the business operation and performance (Neely et al., 2003).

From the perspective of the whole organization each alternative improves profit and incorporates three important budgeting functions: forecasting, operational planning and performance evaluation (Hansen, 2011). Further on we will clarify the concepts used, describe the models' implementation process, and emphasize the associated benefits and drawbacks. Then we will examine the applicability and usefulness of these models in practice.

Activity-based budgeting

Activity-based budgeting (ABB) is not a new idea. It appeared in the late 1990s as an extension of activity-based costing and management (Pietrzak, 2013). Activity-based costing approach is one of the new approaches in costing that have efficiency in providing detailed cost information and identifying valuable activities in the process of cost management (Lotfi&Mansourabad, 2012). This approach led to extend the methodology into planning and budgeting. Activity-based budgeting focuses on creating the budget based on activities rather than units. Moreover, ABB requires determination of the cost of planned activities based on their expected size and resources which they consume.

Usually, companies are using ABB to forecast the demand for activities and also for the usage of the resources they need creating a balance between the demand and available resources, thus creating an operational plan. Further on, the operational plan is used to determine the cost of resources and to create the financial budget. Because revenues and costs are linked to activities, they are allocated more effectively and are not linked to prior year figures, but to actual needs (Hanninen, 2013).

The ABB approached is very well explained by Hansen et al. (2003). According to them the ABB approach involves two stages. First, ABB creates an operationally feasible budget before generating a financial budget. In the operational loop activity-based concepts are used to convert the estimated demand for products and services into activity requirements using activity consumption rates. Once the activity and resource consumption requirements are known the ABB approach works to achieve an operational balance between the resources required to fulfill demand and the resources available. In traditional budgeting, if the initial plan leads to an imbalance, the budget can be balanced only by changing the quantity of demand or resources available. In ABB the organization can adjust the quantity of demand, resource capacity, resource consumption rates or activity consumption rates.

The second stage is the financial loop. In this stage a financial plan based on the operational plan is developed. Financial balance is achieved when the financial plan meets a predetermined financial target. Once demand, activities and resources are known, cost of resources are determined and then this costs are associated to activities and then to products or services. The projected financial results can be viewed in the aggregate or can be separated by resources, activities, products or other cost objects.

Using ABB resource needs could be easily identified; costs can be more accurately associated with activities; costs can be better linked to outputs; the planning process could be more precise and corrections could be done more effective; more realistic budgets could be established (Pietrzak, 2013). According to Hansen (2011) ABB is a new budgeting model which changes and improves operational planning; gives the company more flexibility to react to unexpected events; reduces bureaucracy and time needed in traditional budgeting (Hanninen, 2013). Moreover, if the ABB model is computer based, it can easily be updated to new circumstances (Hansen, 2011).

Still, ABB implementation it's not an easy process, some requirements are needed which may prove to be overwhelming especially for small companies. According to Pietrzak (2013) changes in the business perspective; thorough knowledge of the organization; knowledge about activity based concepts are needed when implementing ABB.

Rolling budgets and forecasts

Rolling budgets along with rolling forecasts are some of the concepts discussed in the contemporary management and managerial accounting literature. Nowadays, companies seek to mitigate their traditional budgeting problems by implementing forms of budgeting and forecasting that allows managers to update budgeted numbers with actual results from past periods. According to Player (2009) "forecasts are used to predict what may happen in the future, often seeking to confirm whether pre-determined annual targets will be met".

A rolling budget is defined as a budget that has a fixed time span, it is updated regularly and provides an overview of the coming periods (Golyagina&Valuckas, 2012). Due to the rolling budget, managers have to rethink the process and make changes each month or each period. The result is usually more accurate, up-to-date budget incorporating the most current information (Banovic, 2005).

Rolling forecasts are used as a replacement to or in combination with a traditional budget, to run the business as conditions change. The definitions of rolling forecast differ among several authors.

Researchers (Sivabalan, 2011; Golyagina&Valuckas, 2012) consider that rolling forecasts are short-term budgets for medium-term horizon and compels the organizations to focus on the future. Others consider that rolling forecasts are financial estimates of likely future outcomes based on current assumptions and economic forecasts about the environment and organization's plan (Zeller& Metzger, 2013); or that rolling forecasts maintains a constant forward-looking time horizon, usually between 12 and 18 months (Hansen, 2011) predicting changes in sales, profit, costs and investments.

Rolling forecasts are used to manage weaknesses of traditional budgeting; allows companies to advance financial and operational management; speed up decision making process and promotes the value-added activities (Lorain, 2010). In order to be efficient the rolling forecasts should be strategically oriented; it should not be as detailed as a budget and must include only key income statement and balance sheet items. Moreover, statistical applications should be used to analyze the data and understand the trends and to set reasonable tends. Forecasts should be closely integrated with budgeting because they are providing the necessary updated information for the budget creation (Golyagina& Valuckas, 2012).

While in traditional budgeting there is a specific period of time during which the planning is done, rolling forecast are updated continuously. Moreover, it promotes flexible resource allocation and planning; it can give accurate projections to estimate capital expenditures, show trends of performance indicators, support decision making and cash management, assist in strategy implementation (Hope&Fraser, 2003).

Besides the benefits rolling forecasts has some limitations also. Researchers (Banovic, 2005) consider that the preparation process can be costly and time consuming; and because the forecasts are reviewed and updated periodically it could become a too complex process for specialists without sufficient training (Lorain, 2010). According to Sivabalan (2011) successful implementation involves skilled and trained accountants and specialists who understand the organizational environment.

Beyond budgeting

The originators of beyond budgeting (BB) are Jeremy Hope, Robin Fraser and the Beyond Budgeting Round Table (BBRT). Beyond budgeting has been proposed as an influential idea that will reinvigorate managerial accounting contribution in business operation and performance and it requires significant changes in the existing management models; reconsideration of the existing budgeting processes and the budgeting mind set.

According to Chartered Institute of Management Accountants [CIMA] (2007) beyond budgeting is a set of guiding principles that will enable an organization to manage its performance and decentralize its decision making process without the need for traditional budgets. BB proposes replacing the rigid annual budget-based performance evaluations with performance evaluation based on relative performance contracts with hindsight (Hansen et al., 2003).

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 targets are reviewed regularly and based on stretch goals linked to performance. 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 (Hope, 2003). Hansen (2011) shares similar ideas. He considers that the beyond budgeting approach starts with the premise that the annual budget and budgeting process are broken and need to be replaced with other control mechanisms. BB focuses on replacing many of the budget's processes with better alternatives making the organization more responsive to the environment.

In order to abolish traditional budgeting changes in the internal business processes are needed. Hanninen (2013) identified six points and leaderships principles that must be changed: target setting; rewarding people; action planning; managing resources; coordinating actions; measuring and controlling performance. To a successful implementation there must be a governance framework with clear priorities and boundaries in every organization; managers should consider carefully the degree of decentralization; there is a need for trust and openness, collaboration and communication at all levels of the organization (Hope&Fraser, 2003; CIMA, 2007). According to Banovic (2005) beyond budgeting is very difficult to implement. It involves the implementation of various complicated systems and requires harmonization in such way that not only the budgeting system but also organizational and cultural environments must radically be changed.

Beside its advantages BB presents disadvantages also. Without budgets, without detailed plans of its current position and future goals organizations can lose direction. Moreover, a drastic culture change can leave employees feeling disillusion and the decentralized structure may be impractical for some organizations (Goode&Malik, 2011).

5. Budgeting in practice

Budgeting is 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. About 90% of companies from all over the world are using budgets for planning, coordination and evaluation of activities; for motivation and evaluation of the staff performance and for supporting the internal control system of the organization (Banovic, 2005; Pietrzak, 2013).

Similar results were found by Dugdale&Lyne (2006) in UK or by Libby&Murray in 2007 and 2010 in the USA and Canada. The survey results show that managers admit the importance of budgets in planning, controlling and performance measuring activities and disagree that budgets leads to dysfunctional behaviour and provides little or no value. Moreover, the surveyed companies indicated that they were not planning to abandon traditional budgeting in the near future. Only a small percentage (smaller than 5%) indicated that they were planning to abandon traditional budgeting in the next two years.

The results show that traditional budgeting will not soon be eliminated.

As for the use of alternative budgeting techniques in practice the literature presents a mixed picture.

To analyze the prevalence of ABB in the world various surveys have been undertaken. Pietrzak (2013) shows that 65.9% of surveyed Dutch companies (international companies, listed on the Amsterdam Stock Exchange) have implemented ABB, including 15.9% where it has been used for the whole company. In Sweden very few companies are using ABB, while all the companies that had implemented some form of activity-based costing were still using traditional budgetary techniques. In Poland results are the same. The spread of the new budgeting alternatives is low.

In 2009 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. The results show that organizations use a range of budgeting tools such as beyond budgeting, flexible budgeting, zero-based budgeting, activity-based budgeting, rolling forecasts, cash forecasts and financial year forecasts. Beyond budgeting seems to be the least popular tool while rolling forecasts and financial year forecasts are the most popular overall. The smallest companies make the least use of budgeting tools; they use less sophisticated techniques as owners have greater control and oversight of expenditure. However, this size effect is not as apparent in the use of the top three budgeting tools. Financial year forecasts, cash forecasts and rolling forecasts are used by all organizations to a similar extent regardless of size.

Nevertheless, several large organizations have begun to experiment with supplementing or even replacing the budget with alternative management control systems. Beyond budgeting practices and applicability is examined in various fields and industries. Hope&Fraser (2003) reported the case of Skandinavian Bank; Mitchell (2005) presented the experiences of six leading North American financial services organization when adopting beyond budgeting; Rickards (2006) presented a report about well known companies (Unilever-health and hygiene; German Railways, IT services, petrochemical manufacturers) being in various stages of successful integration of beyond budgeting; Ostergren&Stensaker (2011) examined beyond budgeting in practice in a large multidivisional oil and energy company.

Starting from the studies carried out we can conclude 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. Each budgeting model produces its own direct or indirect effects throughout the organization, it generates a set of complex interactions and non-intuitive optimal outcomes (Hansen, 2011).

6. Conclusions

This paper contributes to the management and managerial accounting knowledge and literature. It has a theoretical significance because it is the analysis of the literature devoted to budgeting. Theoretical researches, surveys and case studies have been very useful in pointing out specific problems and providing adequate solutions related to budgeting systems. The findings of budgeting studies are contradictory; there are some differences in budgeting systems due to specific business environments and inevitable influences of national and organizational cultures.

The literature and the examined studies show, on the one hand, that companies do not plan to move away from traditional budgeting methods. They prefer modifying it and adapting to the managerial needs with the possible use of new techniques and alternatives. On the other hand, alternatives to traditional budgeting offered today have no persuaded practitioners that they are viable solutions to commonly known problems of traditional budgeting, although each alternative has contributed to the evolution of budgeting. Activity-based budgeting helps to improve the focus and accuracy of budget outputs but it involves more work than traditional budgets. Rolling budgets and forecasts improve forecast accuracy and overcome the traditional budgeting time-lag problem. The beyond budgeting concept is difficult to implement, it involves the implementation of various complicated systems, it radically abandons traditional budgeting altogether.

We consider that alternative budgeting methods are not a standardized solution for budgeting problems for every organization. They are a set of practices used by advanced companies that managed to successfully deal with certain shortcomings of traditional budgeting. Each company has to find out its own combination of management tools and customize them to their internal budgeting system considering each company's culture, structure, history, IT infrastructure and other internal needs.

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