

Beyond Budgeting: The Way Forward?

Michael Goode

M.Sc Accounting and Financial Management Programme
University of Hertfordshire
Hatfield AL10 9AB, UK
Email: m.goode@herts.ac.uk

Ali Malik, PhD

Senior Lecturer and Programme Tutor
University of Hertfordshire
Hatfield AL10 9AB, UK
Email: m.a.l.malik@herts.ac.uk

Abstract

Beyond Budgeting has been proposed as an influential idea that will reinvigorate management accounting contribution in business operation and performance. It is claimed that the traditional system has lost relevance with the modern business environment and is no longer satisfying the needs of managers. Budgets have been ingrained in the culture of business since their inception in the 1920s and managers will find it extremely difficult to radically shift to a system without budgets. The implications of a Beyond Budgeting system are; performance measures relative to competitors and a decentralised organisation structure. Alternatives such as the Better Budgeting techniques may be more favourable to management who desires a formal planning and control system. The Beyond Budgeting concept is still in its infancy and requires further development and practical implementation.

Keywords: Budget; Beyond Budgeting; BBRT; Management Control

I. Introduction

Beyond Budgeting has been proposed as an influential idea that will reinvigorate management accounting contribution in business operation and performance. According to Hope and Fraser (2003) the budgeting system, as implemented by most businesses, should be eradicated. The budgeting debate has arisen due to a movement into the information age (Drury, 2008). It is considered that 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 limitations and weaknesses of traditional budgeting system will be supported with appropriate references. At the heart of this paper is the evaluation whether the Beyond Budgeting model is more relevant in today's business environment and if it can be a prominent tool in the future practices of management accounting. After critically evaluating academic scholars' views on this issue, a conclusion will be drawn as to whether Beyond Budgeting really is the way forward.

This article is organised as follows: Section II introduces and discusses evolution of various concepts of budgeting; Section III discusses limitations of traditional budgeting; Section IV discusses how beyond budgeting addresses the limitations of traditional budgeting and is indeed the way forward and finally section V concludes.

II. Evolution of Various Concepts of 'Budgeting'

Bhimani et al. (2008) define a budget as a quantitative future plan created by managers to assist the implementation of this plan. Becker et al. (2009) state the common view is that at the foundation of management accounting systems is budgeting. In the 1920s budgets were born in order to help managers control costs and cash flows (CIMA, 2007). This concept grew into fixed performance contracts involving future income and expenditure estimations. Budgets were used to drive and evaluate management performance. Furthermore, Rickards (2006) believes the main purpose of budgets is to help implement a firm's strategy, not just controlling and planning. The changes in the economic environment and business processes led to evolutions in budgeting. From the initial cash budgets to more modern techniques of zero based budgeting (ZBB) and activity based budgeting (ABB). Drury (2008) details six functions of traditional budgets: Refining the company's long term plans; Coordinating the different departments and helping to improve relationships between them; Communicating ideas and expectations from top management to all other employees; Motivating managers to achieve challenging targets and goals.; Controlling the business activities using variance analysis to determine areas requiring attention; Evaluating the performance of managers in relation to achieving targets.

A study of 40 managers revealed that budgeting is still very popular (Dugdale & Lyne, 2006). They found that all businesses in question were using budgets and that when used alongside other tools; budgets can harmonise, motivate and control. Budgeting is ingrained in the cultures of many companies; therefore it can be difficult to convince managers that the business will be better off without them (Libby & Lindsay, 2007).

Daum (2002) argues that in the dynamic business environment managers should be looking to grow, expand, exceed targets and limits, and not be restricted by them. He describes many features of this environment such as; complex activities, innovation, retention of good employees. The new business environment is vastly different from the 1920s and although budgets have evolved to adapt to these changes, they are increasingly coming under criticised.

III. Criticisms of Traditional Budgeting

The traditional budgeting methods are considered too time consuming and unresponsive to external changes. According to a research by Neely et al. (2003) the budget creation uses 20% of management time. Following on from this, Bartram (2006) found that even the leanest and most efficient companies take 79 days to organise their budgets, whilst 210 days are spent in the worst practice companies. This is a considerable amount to time for a firm to spend on an activity that arguably adds no value to the business.

The budget culture has restricted the ability for a firm to reshape into a modern business because the budgets reign and contain management behaviours into old

paradigms (Hope and Fraser, 1997). In today's environment the traditional systems of frequently found to be an obstacle to innovation and enterprise by management (Daum, 2002).

Daum & Hope (2003) highlight the growth of organisations as a factor in causing the irrelevance of traditional budgeting methods. Previously, businesses were smaller and staff relationships were built on trust. Trust to act in the best interests of the company. The expansion and development of multinational companies has caused a break down in trust between employees. To combat this, budgets were used as systems of control. However, now this control aspect has become a restriction to progress for a modern and forward thinking company.

The following are weaknesses suggested by Neely et al. (2003) and they advocate these as an area for improvement. Budgets lack strategic focus and value creation, instead the aim is always cost reductions. The bureaucratic style restricts flexibility which in turn impacts a firm's creative instincts. Annual budgeting is too infrequent therefore feeding into the unresponsive argument. Employees may not react well to having controls forced onto them thus having the potential to de-motivate. Also the top down style of budgets strengthens vertical command structures, which can lack adaptability and responsiveness. Working to budgets can cause dysfunctional behaviour as managers are often under pressure to meet targets, this behaviour is also known as budget games.

Bartram (2006) breaks down budget games into five areas. Firstly, 'The Sky's the Limit', this entails management pushing the boundaries and trying to get as large a budget as possible instead of asking for just what they need. This feeds into 'Mine's Bigger than Yours' whereby managers use the size of their budget to judge their own status within the company. 'Cooking the Books' relates to a delay of declaring revenue if the targets are already met so that they can use this revenue to meet future objectives. Next is 'Hey Big Spender', managers feel that they must spend the entirety of their budget otherwise it will be cut next year. Finally, 'Bonus or Bust' is concerned with the managers focus on measures that impact their own salaries or bonuses, whilst ignoring targets which may be more vital to long term success.

On the subject of budget games, Jensen (2003) feels the integrity of the whole firm can be compromised when managers partake in this type of behaviour. The traditional system is based on a flawed principle; reward managers for meeting targets but punish if they fail to do so. This only encourages the type of dysfunctional behaviour described by Bartram. In order to end these games, Jensen proposes abolishing the using budgets as a system for rewarding performance. Otley (2003) believes budget system has the potential to create dysfunctional behaviour and discusses his experience of a coal mine that held back stock to meet weekly quotas, an example of 'Cooking the Books'.

The majority of criticism of traditional budgeting methods has been published by the proponents behind the Beyond Budgeting movement, Hope & Fraser. Their initial criticisms were used as a spearhead to create a better management tool. Traditional methods rely on past information which can have negative knock on effects. An example is the incremental budgeting tool, where the previous year's budget is slightly adjusted for the new year without any analysis into areas which are over/under performing. The performance evaluation is generally carried out at the end of the budget period; this can

be too late to remedy deficiencies. Leading on from this, the common practice is to carry out fixed percentage cuts when early results appear unacceptable (Hope & Fraser, 2003). Libby & Lindsay (2007) feel that the problems are originating from how budgets are implemented and used within business, if used correctly they still can be a very effective tool. Ekholm & Wallin (2010) agree with Libby and Lindsay, and add that if properly used traditional budgets are a strong framework to plan and measure a company's operations. Therefore it can be suggested that many of the inadequacies of traditional budgets could be down to the implementation and not the tool itself.

Despite the reasoning behind these limitations, Hope and Fraser (1997) report that 99% of European companies use formal budgeting procedures, this figure is likely to remain high even today. In addition, a survey of US organisations by Libby & Lindsay (2007) revealed that over 50% of senior managers felt businesses could not cope without budgets and that they were imperative to success. Managers also believed that despite the associated time and costs, budgets were adding value to a company. Ekholm & Wallin (2010) feel the annual budget is not dead yet, but it is past its peak and has lost usefulness and become outdated.

IV. Beyond Budgeting

Beyond Budgeting promotes the most ideal characteristics of a budgeting system; flexibility, coordination and responsiveness (Pilkington & Crowther, 2007). It is not just another system of tools; it requires a complete overhaul of the organisations culture and a shift in the management style (Becker et al, 2009). Hansen (2011) states this can be performed in two stages; move toward performance evaluation relative to competition and then implement a decentralized structure. Hope & Fraser (2003) believe the limitations of traditional budgetary systems require businesses to abandon budgeting altogether and instead focus on financial and non financial measures. The process should look to external benchmarks and competitors rather than internally set targets.

The restrictive nature of budgets is removed and this can enhance the potential of a firm whilst empowering employees to make better decisions. Player (2003) describes Beyond Budgeting as extreme approach but with vast benefits to be realised. A key problem area is with rewarding managers using traditional systems. A Beyond Budgeting reward system is far more appropriate as it is relative to performance measures, often derived from competitors and benchmarks (Hope & Fraser, 2003).

Daum & Hope (2003) argue that Beyond Budgeting is a more adaptive approach to management, with more frequent performance reviews. A second feature is that centralized and hierarchical structures are converted to a decentralized management style. This empowerment pushes authority and decision making to lower levels of the business. The effect can be found in increased productivity and motivation.

Managers have embedded budgets into their culture so it is likely they will struggle to manage without them. Hope and Fraser (2001) believe that the volatile nature of the environment mean budgets and plans are redundant. Budgets try to remove surprises from business. Instead, managers should embrace them and look to them as opportunities for improvement. They continue by saying that in order to take full advantage of the opportunities lower level staff need the authority to make strategic decisions. Furthermore the removal of budgets creates extra time for managers spend on

problem solving and adding value to the business, as the time taken to prepare budgets is a particular disadvantage (Ostergren & Stensaker, 2011).

The Beyond Budgeting model is becoming increasingly popular and many companies are now following its principles. Hope & Fraser (1997) discovered that the Scandinavian bank Svenska Handelsbanken abolished all forms of traditional budgeting in 1979. Since then it has grown into the largest bank in Scandinavia and one of Europe's most efficient banks. Their CEO reported that a cultural change from budgets and targets to improvement has enabled costs to be driven down. Daum (2002) states that Svenska Handelsbanken utilised a decentralised structure to enable each branch to run as an independent profit centre. This is an example of the potential that Beyond Budgeting can unlock.

The Beyond Budgeting Round Table (BBRT), a network designed to transform the traditional budget system, studied 14 companies without budgets or almost without budgets and from this they produced 12 guiding principles to Beyond Budgeting:

- i.** Measure performance against the competition, not internal targets.
- ii.** Motivate employees by empowerment.
- iii.** Delegation to divisional managers allows them to take responsibility.
- iv.** Give operational managers independent access to resources.
- v.** Create customer focused teams.
- vi.** Provide transparent information sharing across the organisation.
- vii.** Set targets on external benchmarks.
- viii.** Rewards in line with beating the competitors.
- ix.** Allow managers to be involved with strategy planning.
- x.** Grant management access to local resources.
- xi.** Coordinate the internal use of resources.
- xii.** Performance measurement information should be available freely.

(Daum, 2002)

Pilkington & Crowther (2007) have found that Beyond Budgeting is most commonly adopted by large firms employing over 1,000 people. The smaller firms (10 - 50 employees) tend to impose strict budgets for employees to follow. This is likely to be due to the size, management style and ability to train staff in unfamiliar concepts.

DeWaal (2005) suggests an entry scan before implementing Beyond Budgeting to ensure that staff feels the current systems are failing. The scan creates discussion into whether staff wants, and if the organisation can, implements Beyond Budgeting. The main advantage of questioning the employment of Beyond Budgeting is that staff will feel involved in decision making and internal business processes.

Beyond Budgeting appears to have many advantages over traditional systems but it is not without criticism of its own. CIMA (2007) believe that 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. Finally, a drastic culture change can leave employees feeling disillusion and the decentralized structure may be impractical for some organisations.

An alternative option for firms that still want a formal budgeting system is Better Budgeting. Better Budgeting entails five techniques that can be used to overcome some of the limitations of traditional methods (Neely et al, 2003). Activity Based Budgeting involves planning using value adding activities, following a similar concept to ABC and ABM. Zero Base budgeting forces managers to justify their budgets every year to try and prevent dysfunctional behaviour and budget games. Thirdly, a Value Based technique encourages a focus on creating shareholder wealth and linkages with strategy. Profit methods consider both short and long term projections whilst ensuring sufficient cash is generated. Finally, Rolling Budgets create frequent budgets to provide more accurate forecasts. A major problem with Better Budgeting techniques is that they can actually take even more management time to be used effectively, which is likely to cause greater dissatisfaction with the processes.

The Beyond Budgeting movement is still in the early stages of development and Rickards (2006) feels that further research and practical implementations are required before a real breakthrough in management accounting is achieved. Becker et al (2009) believe that the initial fascination with Beyond Budgeting is fading and that some principles are being put into practice, just not under the umbrella of Beyond Budgeting. Decentralisation and empowerment may be growing in popularity due to the current business environment.

V. Conclusion

To conclude, Hope's view is that Beyond Budgeting is a far more effective system which conquers the limitations of traditional methods. He foresees the international expansion of the BBRT and that Beyond Budgeting will become a 'major management theme for the future' (Daum & Hope, 2003). After evaluating the thoughts and opinions of various academics, this article believes that Beyond Budgeting has an important role to play in the future of management accounting. However, it is unlikely that it will be fully adopted as the BBRT imagined; a number of principles are extremely useful within the modern environment. These may be adopted but management will find it hard to completely abandon budgeting, as it is embedded in business culture. Perhaps some Better Budgeting techniques could be practiced in order to update the failing traditional system. This article supports the argument that traditional budgets are outdated and no longer appropriate for the current environment. Furthermore, budgets can actually destroy shareholder value within a firm therefore it is vital that new systems are developed. It is the view of this article that the traditional budget requires refreshing and revitalizing but is not yet ready for removal.

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