

The different types of budgeting systems



Budgeting systems of different types, usually customised to the needs of individual organisational managements, are in use in various types of organisations, business, governmental and not for profit, across the world.

The use of traditional budgeting has in recent years come under intensive critique by different academic and experts for its detrimental impact on different organisational areas and especially upon the overall performance of organisational employees and consequently of organisations. Such developments present a difficult conundrum to organisational managers of the actual utility of budgets in performance management and control.

This dissertation takes up the investigation of the role of budgeting in organisational performance, especially so in planning and control of organisational activity, both in theory and in practice. The information obtained from intense study of literature is augmentation by the investigation of budgeting practices at two leading fast food and restaurant chains, Pizza Hut and Burger King.

The research reveals that whilst traditional budgeting practices dominate organisational policies for planning and control, modern budgeting concepts are slowly being adopted by organisations with some success.

1. Introduction

1. 1. Overview

Budgeting systems of different types, usually customised to the needs of individual organisational managements, are in use in various types of organisations, business, governmental and not for profit, across the world (Andrews & Hill, 2003, p 135-158).

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Traditional budgeting methods emerged as important management tools in the pre Second World War era, when Fordist and Taylorist management principles directed the working of most business organisations (Grizzle & Pettijohn, 2002, p 51-58).

Traditional budgeting techniques involve the comparison of actual organisational performance in different areas of work with budgeted targets, the computation of variances between budgeted targets and actual performance, and the analysis of both favourable and unfavourable variances in order to determine the reasons for such differences (Pilkington & Crowther, 2007, p 29-30). The chart provided hereunder explains the sequence of budgeting activities and the relationship of the process to internal and external factors (Tales, 1998, p1).

Variance analysis helps in corrective action during the currency of an operating period and helps organisations to achieve various objectives. Analysis of variances and comparison of actual achievement with budgeted targets help in the measurement of performance of responsibility heads, managers, groups of employees, and individual employees (Pilkington & Crowther, 2007, p 29-30).

Budgetary control has over the years been found to be very useful for planning and controlling of organisational performance (Chapman et al, 2007, p 7-51). Budgets have also been found to be useful in the monitoring and achievement of group objectives and in the facilitation of team work (Chapman et al, 2007, p 7-51).

Budgeting, despite its inherent utility in the planning and control of organisational performance, has come under increasing criticism from modern day management accounting experts like Kaplan, Argyris, Hofstede, and Hopwood, who argue that lack of thought and rigidity in the use of budgeting essentially results in the development of Theory X type management control tools that can cause various organisational problems like increased stress upon employees, organisational disagreement and dissention with inappropriately set budgets, and organisational demotivation (Chapman et al, 2007, p 7-51).

Recent years have seen the development of modern budgeting techniques like the balanced score card, rolling budgets and beyond budgeting techniques (Chapman et al, 2007, p 7-51). Whilst such new concepts in the area of budgeting are undoubtedly being taken up for discussion, study and implementation by some progressive firms, the overwhelming majority of business organisations continue to use traditional budgeting techniques suitably customised to the circumstances and needs of individual organisations (Chapman et al, 2007, p 7-51).

1. 2. Purpose of Study

The use of traditional budgeting has in recent years come under intensive critique by different academic and experts for its detrimental impact on different organisational areas and especially upon the overall performance of organisational employees and consequently of organisations. Such developments present a difficult conundrum to organisational managers of the actual utility of budgets in performance management and control.

This dissertation takes up the investigation of the role of budgeting in organisational performance, especially so in planning and control of organisational activity, both in theory and in practice. The information obtained from intense study of literature is augmented by the investigation of budgeting practices at two leading fast food and restaurant chains, Pizza Hut and Burger King.

This dissertation should hopefully help students, managers and academics through the generation of new perspectives in the area and help in improving the process of planning and control of organisational activities through the use of appropriate budgeting techniques.

1. 3. Aims and Objectives

The aims and objectives of this dissertation are now elaborated as under:

To examine the elements of budgetary control and its application in actual practice.

To examine the various actions involved in the preparation and planning of budgets, with special reference to the role and importance of accurate information inputs.

To examine the key resources required by firms for gathering of information for the preparation and planning of budgets.

To examine the limitations of budgeting.

To examine recent developments in budgeting and recommend the adoption of the most appropriate system of budgetary control by organisations.

1. 4. Structure

This study has been sequentially structured. This introductory section is followed by a literature review and thereafter by the formulation of appropriate research questions. Subsequent sections take up the description and explanation of the adopted research methodology, the data obtained from such research, the analysis of data, and finally conclusions and recommendations. An extensive alphabetical list of references at the end of the study provides details on all source material used for the dissertation.

2. Literature Review

This review of existing literature attempts to examine the published material available in the public domain on the issue of budgeting and its role in performance management of organisations, departments and employees.

Budgeting emerged as an important management accounting and management control tool in the early years of the 20th century and forms a staple item of all text books on financial management and management accounting (Davila & Foster, 2005, p 1039-1068). The budgeting process came under severe criticism in the 1980s with the publication of critiques budgeting by experts like Kaplan, Argyris, Hofstede and Hopwood. Recent years have seen the emergence of newer budgeting techniques like flexible budgeting, rolling budgets, the balanced score card approach, and beyond budgeting techniques (Davila & Foster, 2005, p 1039-1068).

2. 1. Role of Budgeting in Planning and Control Activities

Planning and control are agreed to be among the most important of organisational managerial activities (Bhatnagar, et al, 2004, p 92). Budgets

play a central and key role in the planning and control processes of business firms. The importance of budgets in planning and controlling functions makes management accounting and the provisioning of management information a critical organisational function. Surveys of UK business and industry reveal that most business organisations use budgeting techniques of some form, even as larger organisations have institutionalised and developed budgeting mechanisms (Bhatnagar, et al, 2004, p 92).

The role of budgeting is best examined by locating its place within the wider framework of organisational planning and control (Carruth & Digregorio, 2003 p 13-26). The chart provided hereunder explains the relationship of budgeting in the larger control framework of a firm. Management and operational control form very important components of the broader framework of planning and control. Management control represents the process through which managements ensure the execution of pre-determined strategies by their organisations (Carruth & Digregorio, 2003 p 13-26). The process is essentially short term in nature, implemented through middle rung managers, and forms an important routine management activity. Operational control on the other hand represents the process of ensuring the efficient and effective conduct of specific tasks. The time spheres for such controls are short term, consist of periods that can extend from a day to a month, and are executed through junior managers (Pilkington & Crowther, 2007, p 29-30).

With regard to planning, the use of budgets calls upon and directs managers to think ahead about the utilisation of resources for achievement of company policies and objectives in their area of work (Grizzle & Pettijohn, 2002, p 51-
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58). Such planning involves the obtaining of relevant, accurate and valid information, (either from reliable historical sources or by logical estimation), the analysis and appropriate extrapolation of such information, and its use for projection of future operational figures in different areas like sales, production, income and expenditure (Grizzle & Pettijohn, 2002, p 51-58).

The relevance and effectiveness of budgets is to a large extent dependent upon the accuracy of information on which it is based (Hassel & Cunningham, 1996, p 245). The overwhelming majority of budgeting exercises make use of historical information that is available within organisations. Important environmental information is also however often used by management accountants for projecting future developments and their impact on performance (Hassel & Cunningham, 1996, p 245).

Inaccurate or unreliable information can, it will be obvious, erode the reliability and credibility of the assumptions on which budget preparation is based, and therefore invalidates budgets (Craig, 2002, p 57). Modern day organisations, especially if they are large, adopt elaborate and complex methods for retrieval, study, investigation and analysis of the data needed for budgets. Manual accounting inputs for preparation of budgets have largely been discarded by most organisations (Craig, 2002, p 57). Complex accounting and information retrieval systems that span departments, functions and geographies are used by most large organisations. Modern day Enterprise Resource Planning (ERP) plays an important role in the provisioning of management information in the preparation of budgets (Hassel & Cunningham, 1996, p 245).

The control function of budgets is executed through the allocation of responsibility to specific individuals for the achievement of specific budgeted targets and by the comparison of actual performance with budgeted targets (Craig, 2002, p 57). Such comparisons result in the establishment of positive or negative variances and reveal the extent to which people with responsibilities have been able to achieve their specified tasks. The extent of variance denotes the margin of success or failure (Pollitt, 2006, p 25). The reasons for such variances can be examined to ascertain the causes of success or failure of employees with accountability. Budgets have traditionally proved to be effective in performance control because they (a) establish specific, pre determined, and logically computed targets, (b) allocate responsibilities to specific organisational employees for achievement of targets, (c) establish widely known and uniform performance yardsticks and benchmarks, (d) provide a basis for assessment of actual performance and (e) pinpoint the people who can be held to be responsible for organisational failure, and (f) allow for analysis and determination of causes of failure (Pollitt, 2006, p 25).

Budgets help in controlling performance by establishing benchmarks for performance and consequently for rewards against such performance (Andrews & Hill, 2003, p 135-158). Organisational employees are often promised and provided rewards on the basis of their success in achieving targets in different areas of work (Andrews & Hill, 2003, p 135-158).

2. 2. Limitations of Budgeting

Budgeting undoubtedly constitutes a critical and essential component of management control techniques that are employed by business firms for planning their future actions and thereafter controlling them.

Whilst the importance and role of budgeting in achievement of organisational objectives and competitive advantage is widely accepted and also illustrated by the fact that the overwhelming majority of business firms across the world engage in some type of budgeting activity, the process has come under severe criticism in recent decades (Chapman et al, 2007, p 7-51). Experts like Kaplan have argued that traditional budgeting techniques have essentially not changed over the last 70 years and have become increasingly inappropriate for the modern day economy and the changed internal and external environments in which business firms operate (Chapman et al, 2007, p 7-51). Whilst traditional budgeting operates both on top down and bottom up approaches and are based both upon historic information and current information that is available in the public domain, budgets are in the overwhelming majority of cases finally decided by top management and imposed upon different levels of organisational managers (Chapman et al, 2007, p 7-51).

Such imposition of budgets and their association with performance measurement, rewards, remuneration, and career progression of organisational employees leads to the development of various complexities, some of which are elaborated as under.

Budgets are very infrequently felt to be fair and right. Budgeted targets are by and large felt to be either too soft or too hard, depending upon the perspectives of different persons (Hassel & Cunningham, 1996, p 245).

Such perceptions often lead to organisational dissention and ill will between subordinates and superiors and broad resentment of employees against organisational authority (Chapman et al, 2007, p 7-51).

Soft budgets are felt to be contradictory to organisational well being and build environments of complacency and slackness. Difficult budgets on the other hand often prove to be unattainable and lead to de-motivation, resentment, criticism, dissension, and ill will. It is thus not an easy task to formulate a budget that furthers organisational objectives, stretches organisational employees to improve their performance, and acts as a good motivator and fair tool for judgement of performance (Hassel & Cunningham, 1996, p 245).

Argyris and others have pointed out that group attitudes towards budgets significantly affect performance and ultimate achievement of budget targets (Smith, 2001p 1).

Geertz Hofstede elaborates that appropriate setting of targets is also very important for achievement of budgets. Hofstede states that whilst group participation was important, the attitudes of senior managers, especially the game spirit with which they play the budget game form a key ingredient of the budget process. (Hofstede, 2003, p 12-18)

Hopwood (1972) identified different styles of budgeting, the budget constrained style, the profit conscious style and the non-accounting style. Whilst all three styles exerted pressure on workers, it was only the profit conscious style that drew involvement without eliciting defensive approaches (Hopwood, 1972, p 156-182)

Hope and Bunce assert (2003) that autocratic and rigid budgeting approaches lead to the development of organisational bureaucracies that focus on finding fault with employee performance, rather than motivation and encouragement (Hope & Bunce, 2003, p 1).

Undue emphasis on achievements of budgets can divert management attention from other important organisational aspects like the importance of quality and staff morale with detrimental impact upon organisational wellbeing (Hassel & Cunningham, 1996, p 245).

The association of monetary and career rewards with the achievement of budgets can lead to a range of unethical activities like fudging of figures, window dressing of performance, and skirting with the law. The wrong decisions taken by managers of banks and financial institutions, (which greatly contributed to the development of the financial crisis of 2008) are closely related to the greed of managers to access the performance bonuses that were linked to achievement of ever-increasing performance targets (Chapman et al, 2007, p 7-51).

2. 3. New Developments in Budgets

Dissatisfaction with important aspects and outcomes of traditional budgeting principles has led to extensive research in alternative methods of

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optimisation of organisational and individual control and performance (Hearn, et al, 2006, p 286). Such efforts, both in areas of theory and practice, have resulted in a number of alternative approaches and modifications to traditional budgeting theory and practice. Some of the more important of these developments are represented by flexible budgeting, rolling budgets, the balanced score card approach and beyond budgeting principles (Hearn, et al, 2006, p 286).

Rolling budgets are prepared for 6-9 months in detail, (unlike traditional financial budgets that are made for complete financial years), followed by broader and less detailed budgets that extend to 1 ½ to 2 years (Subramaniam & Ashkanasy, 2001, p35).

Flexible budgets on the other hand deal with operations and contain different estimates for various products and services (Subramaniam & Ashkanasy, 2001, p35). Such methods allow for changes in costs or volumes and allow organisations to respond swiftly to changing situations and thereby maintain profitability and competitive advantage (Subramaniam & Ashkanasy, 2001, p35).

The balanced score card approach aims to translate strategy into practice from four dimensions, namely customer, financial, learning and growth, and business processes (Bhatnagar, et al, 2004, p 92). Its use helps organisations to pay attention to different aspects of organisational performance over the length of business cycles, which are longer than traditional budget periods and thus essentially more volatile. The use of this approach, along with Key Performance Indicators, (KPIs), enables organisations to built holistic targets

and track performance in different dimensions (Bhatnagar, et al, 2004, p 92). Beyond Budgeting is a comprehensive and elaborate holistic approach that incorporates modern concepts like rolling budgets and the balanced score card approach and focuses on two groups of principles related with performance management. The first group of principles is process oriented, whilst the second set is leadership oriented. Taken together Beyond Budgeting principles enable organisations to motivate their employees, improve performance and enhance organisational creativity (Bhatnagar, et al, 2004, p 92).

2. 4. Framing of Research Questions

The research questions for this dissertation, framed in line with the aims and objectives of the dissertation and the results of the literature review are detailed as under:

How does budgetary control help in planning and controlling of performance of employees?

How are budgets used by successful organisations (Pizza Hut and Burger King) to plan and control performance?

How do organisations ensure accuracy of information for preparation of budgets?

What types of resources are used by organisations to gather information and prepare budgets?

What sort of constraints and limitations do modern day organisations face in using traditional budgeting techniques?

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What measures can be adopted by organisations to make budgeting exercises more effective in planning and controlling performance?

3. Research Methodology

3. 1. Important Research Factors

Research in areas of finance, management, and business come under the broad ambit of economic research (Bryman & Bell, 2007, p 12-28). The research methodology for such assignments is by and large determined in accordance with the tenets of social research and is of course shaped by the nature of the subject under investigation and the infrastructural and other resources available with the researcher. The determination of appropriate research methods and techniques involve the choice of specific research methods and the most suitable sources of information (Bryman & Bell, 2007, p 12-28).

3. 2. Quantitative and Qualitative methods of Research

Social research methods are shaped by two broad and quite different research approaches, namely the quantitative approach and the qualitative approach. These approaches are shaped by different epistemologies and involve the utilisation of different research techniques, both for obtaining and for analysis of data (Darlington & Scott, 2002, p 33-47).

The quantitative approach is guided by positivist epistemology and is closely related to scientific research methods (Darlington & Scott, 2002, p 33-47).

Quantitative approaches involve the application of scientific theory and aim to measure the responses of research subjects in easily quantifiable and numerical terms. Such methods are used in the majority of economic and

business research efforts and are particularly useful in the gauging of broad trends of thoughts or opinions of chosen populations (Darlington & Scott, 2002, p 33-47).

Qualitative methods of analysis are essentially different and are used when the issue under study is subjective in nature and open to different ways of interpretation (Neuman, 2005, p 18-36). Qualitative research methods are shaped by interpretivist epistemology and involve detailed investigation of complex subjects that are often multilayered and incapable of being answered with yes or no responses. Such research is most appropriate for issues that involve questions that are what, why and how in nature and are best conducted by expert and involved researchers (Neuman, 2005, p 18-36). Qualitative research is far more time consuming and detailed than quantitative research and is mostly conducted with the help of direct one-to-one interviews and focus group discussions, in which researchers participate with the subjects under study and observe their reactions and responses in minute detail (Neuman, 2005, p 18-36).

Whilst most research assignments call for the use of either quantitative or qualitative methods, some complex and multidimensional issues require the use of both techniques (Neuman, 2005, p 18-36).

3. 3. Choice of Information Sources

Information sources are broadly categorised into primary and secondary sources. Secondary information sources consists of all the information on the subject that is available to the public at large in the form of published

material, more specifically books, articles, both journal and magazine, and other publications (Bryman & Bell, 2007, p 12-28).

Primary information is however obtained from sources that are part of or are integral to the subject under study (Bryman & Bell, 2007, p 12-28). Whilst primary information is most commonly obtained from interviews and focus group discussions, such information is also available from specific public domain sources like organisational or departmental publications, publications authored by the subjects under study, interviews given by them to reliable media publications, and otherwise from information disseminated through personal or organisational websites. (Bryman & Bell, 2007, p 12-28).

3. 4. Adoption of Research Methodology

The subject issue, as detailed by the aims and objectives, the literature review and the research questions of this study, is essentially complex, multilayered and open to interpretation in different ways (May, 2001, p 41-59). The use of budgeting techniques for planning and controlling performance in business organisations is an intensely debated topic and has multiple aspects. The interests of research on this issue will certainly not be appropriately served with the use of yes/ no/ multiple choice surveys administered to sample population groups (May, 2001, p 41-59).

The elimination of quantitative methods of research for the assignment by extension also removes the relevance of mixed models and leaves only qualitative methods for use (Neuman, 2005, p 18-36). This research study therefore uses only qualitative methods for researching information. The research approach has been formulated on the basis of the aims and

objectives of the dissertation and the information unearthed during the literature review (Neuman, 2005, p 18-36).

This research effort attempts to obtain answers to the research questions through a detailed investigation of the budgeting practices of two well known and successful organisations in the fast food and restaurant industry, namely Pizza Hut and Burger King UK. Information for research has been obtained from a host of secondary and primary sources (Neuman, 2005, p 18-36).

Study of information available in the public domain on the use of budgets for planning and control of performance in these organisations will provide a balanced multi-prospective view of their organisational policies and practices (Neuman, 2005, p 18-36). Primary information is sourced from an examination of organisational websites, observation of their work processes onsite and informal open ended discussions with members of their staff. The information obtained from secondary and primary sources has been carefully collated and thereafter subjected to appropriate analysis (Neuman, 2005, p 18-36).

3. 5. Ethics

Appropriate care has been taken to ensure the adoption of ethical rules and norms that are pertinent to business research (Bryman & Bell, 2007, p 12-28).

All information sources used for the purpose of study have been acknowledged carefully and comprehensively. All participants have been informed of the nature of the assignment and its purposes. Respondents have been informed of their right to confidentiality and of refusing to answer

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all or any of the questions asked of them. All respondents have also agreed in writing of their unilateral and unforced willingness to participate in this study (Bryman & Bell, 2007, p 12-28).

3. 6. Limitations

The results of this study are limited by the actual reading carried out by the researcher. Whilst efforts have been made to ensure extensive examination of available literature, it is always possible that some important information may have been missed out (Darlington & Scott, 2002, p 33-47). The actual investigation of businesses for ascertainment of budgetary control in practice is also restricted to two organisations, which may well be unrepresentative of the entire business fraternity. The result of this research study is subject to these limitations (Darlington & Scott, 2002, p 33-47).

4. Data and Findings

Information for research has been obtained from a range of secondary and primary sources. Secondary information on budgeting at Pizza Hut and Burger king has been obtained from information available on the subject from a range of sites in the public domain, even as primary information has been obtained by study of their organisational web sites. The information sources used for secondary information on budgetary control for Pizza Hut and Burger King have not been cited here but have been placed together at the end of the list of references for easy access.

Primary information has also been obtained by visits to retail outlets of Pizza Hut and Burger King in London, observation of the work processes at these outlets and open ended conversations with their employees.

It has been difficult to obtain relevant information on budgeting because information about budgeting practices belongs to the private information domain of the companies and is not openly discussed at public forums. The employees at such outlets are also more involved in servicing customers and their knowledge of budgetary control methods is restricted. Relevant information has however been accessed from discussions with middle managers at Pizza Hut stores and franchise representatives at Burger King.

The information obtained from study of public domain information, onsite observations and interviews with middle managers of Pizza Hut and Burger King are provided below:

Information from Study of Public Domain Information of Pizza Hut

Pizza Hut is a US headquartered multinational chain of restaurants that offers different types of pizza's and associated foods.

The chain which belongs to Yum brands operates in more than 100 countries, contains approximately 34, 000 outlets of different types and employees more than 30, 000 people.

The company is headquartered at Addison Texas and has grown enormously since its founding in 1958.

The company operates its own stores in the majority of its locations in the US. It does however have some franchised units in countries outside the United States.

The company is well known for its high quality and standard food and has faced very few quality complaints.

The HR section on its website and information obtained from the public domain state that the company pays great attention to the selection, recruitment, training and performance of its employees.

Pizza Hut operates a complex and detailed management information system with the help of extensive computer systems that connect all its global units with regional headquarters and to organisational headquarters at Texas.

The computer systems used for the management information function are modern and constantly updated.

Budgetary control forms an integral element of Pizza Huts overall management information system.

The budgetary control system is extremely detailed and is prepared for every quarter of a calendar year.

Budgets are multi dimensional and monitor both operational and financial aspects of the organisation.

Budgets are prepared for all departments, all functions and for each restaurant operated by the chain.

Much of the purchasing functions are done through annual regional contracts and employee of local retail outlets are not involved in these functions.

Employees of retail outlets are however expected to add to organisational sales and competitive advantage through constant improvement of customer relationship and customer satisfaction.

The chain has recently introduced the balance score card method for improving the performance of employees at retail outlets.

Employees at Pizza Hut outlets are now assessed on a variety of counts that concern the provisioning of customer service, the achievement of customer satisfaction, the improvement of customer relationships and finally of the quantum of repeat customers.

The company proposes to extend the balance score card method of budgetary and performance control to other areas of work.

Information from Study of Public domain Information of Burger King

Burger king is also a US headquartered international chain of fast food restaurants.

Headquartered in Florida. Burger King is the second largest seller of hamburgers in the world. It has approximately 12, 000 outlets, operates in 73 coun