

Beyond budgeting essay sample



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The biggest limitation of traditional budgeting system is that it focuses primarily on expenses, paying little attention to the results obtained as a result of the expenses incurred. Thus in the above example, the marketing manager may fail to cash on an opportunity to sell more by increasing the travelling of his sales-persons because that will lead to the travel expenditure exceeding the budget.

The emphasis on input cost to the inclusion of the consideration of results obtained makes budgeting quite meaningless when the level of operations are very much fluctuating. For example, production cost in any company are closely linked to the level of production. Therefore, a rigid budget, that fails to take into consideration the level of production can become quite inappropriate as planing or controlling tool.

Another common problem of budgeting system is related to the way budgets are finalised. In many organizations the budgets are often prepared on the basis of past performance rather than the future requirements. This tends to create a false feeling of planned working, when in reality the organization is only drifting along with the flow of past trends.

There have been many attempts to overcome the limitations of budgeting systems by introducing many innovations such as flexible budgeting, zero based budgeting, and performance budgeting.

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). From the initial cash budgets to more modern techniques of zero based budgeting (ZBB) and activity based budgeting (ABB).

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 of 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, .

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 demotivate. 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

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 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).

Critims of beyond budgeting:

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.

Q2: Types of organisations, its culture and environment affect how successfully a budget might operate?

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. 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.

Q3: solutions to overcome the limitations of traditional budgeting 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.