

Traditional Budgeting in Today's Business Environment

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Abstract

Traditional budgeting has been subject to several controversies with many arguing in favour and against its use. The two sided arguments were discussed with the help of existing literatures. This research provides a conceptual meaning of traditional budgeting as an examination of income with respect to expenditure and developed a model framework for understanding the usefulness of traditional budgeting in today's business environment. A tripod relationship between budget, household and managers was developed & analysed. The research explains the benefits of traditional budgeting and also provides an alternative to traditional budgeting concept in today's business world. The study shows that influence of organisational culture was seen to constitute the bane of traditional budgeting process, implementation and performance management with control as the critical variable at all levels of human endeavours and concludes that budgeting is the panacea for enforcement of control, target, and accountability. It entrenches motivational spirit & managerial direction among workforce, hence should be adopted by both individuals and business entities.

JEL Classification Numbers: M41

Keywords: Traditional Budgeting, Planning, Household, Management, Organisations

1 Introduction

1.1 Overview of Traditional Budgeting

Generally, what is often referred to as traditional budgeting can be called fixed budgeting (Jonsson & Akerlund, 2012). Traditional budgeting sets out income and expenditure plan. It spells out a list of specific financial obligations like feeding, shelter, clothing, transportation and so on including other complex needs of household and entities within a specific period of time in line with income level. It sets out the sources and application of

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funds and defines how income is generated and expended. The major aim of traditional budget according to Anthony and Govindarajan (2007) is to attain organisational goals and objectives. The definition of a budget may vary among organisations. Ax, Johansson and Kullven (2009) simply averred that there is no generally accepted definition of what a budget means to organisation but that its meaning is specific to each organisation. It plays a vital role in an organisation which includes establishing objectives, identifying potential courses of action, evaluating alternative strategic options, selecting alternative course of action, monitoring actual results and responding to divergences from plan. Budgeting has been criticised by experts to be an obsolete method of exerting control in an organisation that takes a lot of time and resources of the organisation. However, this topic will be discussed in six parts; Overview of traditional budgeting, budgeting in today's business, the importance, the arguments in favour and against traditional budgeting, the alternatives including advantages and disadvantages and the influence of organisational culture.

1.2 Budgeting in today's Business

The term budget is common to most business enterprise due to its role in achieving corporate objectives. Budgeting is key to the survival of any business from the point of formation to the point of implementation. Accounting system relies heavily on cost, standard, performance and target information to enable decision makers and the management to prioritise activity within resource limit (Hansen and Van der Stede, 2004). Budget keeps track of organisational performance, goal communication and also enables planning and control mechanisms to be effectively pursued in an organisation. Responsibility centres in any organisation is guided by the budgetary allocations which spells out the vision or the expectations of every unit. It ensures that set targets are achieved within a reasonable time frame. Budget is instrumental to performance evaluation, formation and implementation of strategies, operational monitoring and control mechanism and so on. (Ekholm and Wallin, 2000; Merchant and Van der Stede, 2003). Budgets fundamentally provides a linkage between the organisational goals and performance towards the goals and espouses any limitation in form of evaluation. It communicates both targets and performance to the management and predisposes any favourable performance and punishes slack.

2 Importance of Traditional Budgeting

The budget process is a system of communication between the management and other departments where revenues and costs for the future years are planned (Anthony and Govindarajan, 2007). Budgeting process takes three stages according to Jonsson and Akerlund (2012) which are creation, follow up and analysis. Ax *et al.*, (2009) says that foundation of any budget is the estimate of future revenue or cost while Lagedstedt and Tjerneld (1991) argued that it is the sales statistics that is the foundation of budget. Budget creation is the developmental stage of any budgetary process in an organisation. The second stage which is the budget follow up is the evaluation that compares what was budgeted with the actual result, while the third stage which is the analysis provides the organisation the opportunity to gain from the performance of the budget in the future. Lindvall (2001) suggests that it is used to bring about internal and external influence in organisation. It creates room for improved performance among staff and produces a fertile ground for

speedy decision making process in an organisation. Most organisations see budgeting to be advantageous against the criticism that it is 'obsolete', 'irrelevance', 'unnecessary evil' etc (Hope & Franser, 2003a and 2003b; Jensen, 2001; and Wallander, 1999). Those who support the continued use of budgeting have argued that its benefits outweigh the problems. Hansen and Van der Stede (2004) raised four key reasons for budgeting which are divided into two parts with the first part as planning and performance evaluation (short term and operational in nature) and the second part as goal communication and formation of strategy (long term & strategic in nature). The framework to understanding this is as below;

2.1 Budgeting Framework.

First and foremost, the budget takes a tripod shape where it is only undertaken by either the household (including individuals and families) or the management (including the government, heads of units, managers etc)

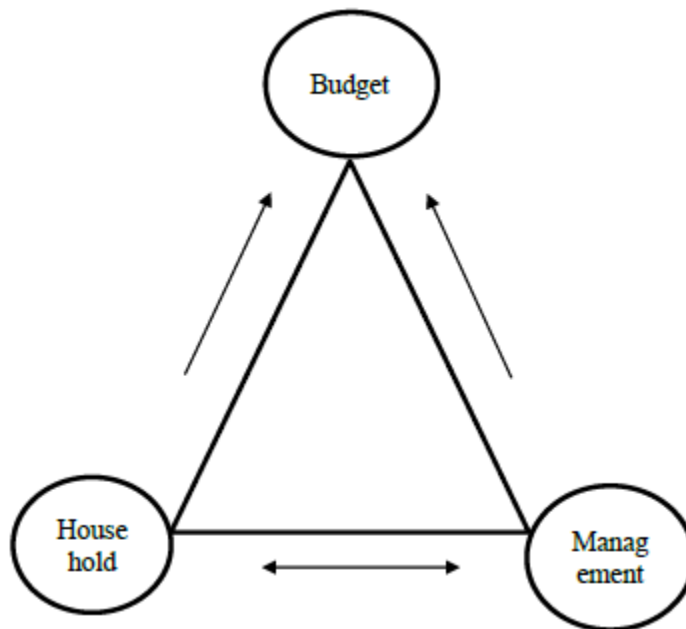


Figure 2.1: Budgeting Tripod

Source: Authors' conceptualisation

The figure above demonstrates that the principal users of a budget are the households and the management. Both units draw budgets and the function is principally the same but may vary in scope. The relationship that exist between budget and the users (household and management) could be likened to that of a man and his computer system. What is put into it is what you get, "Garbage in, Garbage out". The output is totally dependent on the input. When a budget is well designed and implemented, a good result follows in the form of good performance and vice versa when it is poorly designed implemented. The functions of a budget to these identified users are discussed in line with Hansen and Van der Stede (2004).

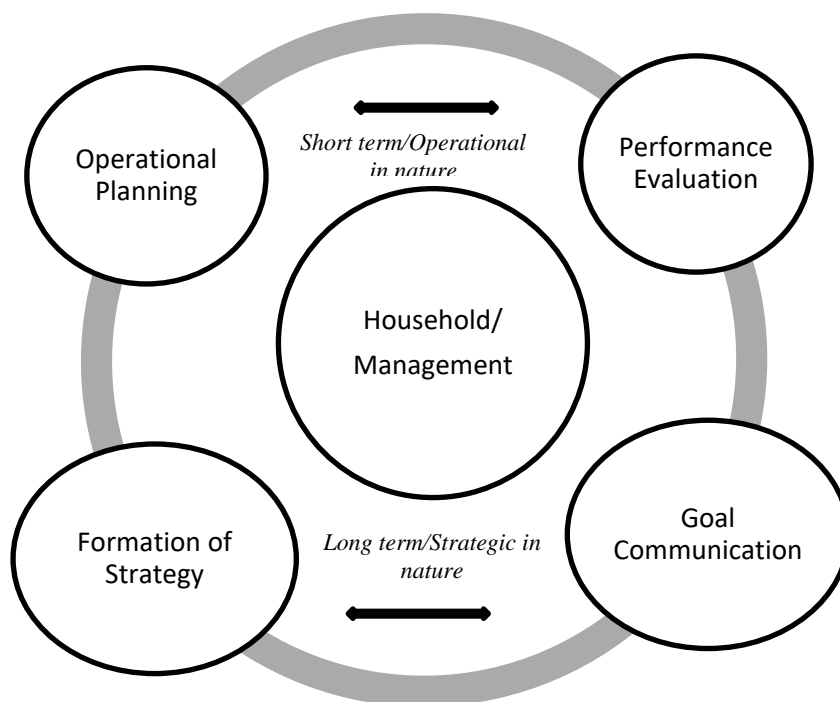


Figure 2.1.1: Functional Framework of Budget

Source: Authors' conceptualisation

Organisational Planning

Budgeting involved setting objectives that are linked to future plan of what to do and expect. It includes financial plans of what to spend and receive; cash budget, functional budget and profit and loss budgeted accounts. At this stage the management or the household considers the exchange rate, inflation rate, market structure, pricing, income level and so on

Performance Evaluation

At the end of an organisation's year, there is usually an assessment of organisational or individual performance and monetary reward could be given for high performance while penalties are meted out for low performance. This is a key function of budget and should be careful with to avoid dysfunction behaviour when applied strictly. Self-assessment may include questions such as: Was set plans achieved? Was target profit achieved? If not what is the reason for not achieving it? Did performance meet up with others in the same line of business? Several studies in the past such as Hartmann (2000); Hope and Fraser (1997), (2000), (2003); Howell (2004); Jensen (2001); Marcino (2000); Schmidt (1992) have considerably focused on the use of budget for performance evaluation on which it was criticised for causing dysfunctional behaviour. The management here will be guided by variance analysis (favourable or unfavourable), break-even analysis, and so on

Goal Communication

The top management cadre in an organisation communicates its expectations to the lower cadre via a budget. Example; it is expected that everyone in the organisation will have a clear understanding of their job functions in achieving the set budget. As a result of this, the management is concerned with compliance oversight, conducts, ethics, and governance and so on

Formation of Strategy

Budgeting is used to enshrine financial and managerial control in an organisation. It helps to monitor expenditure and income, identify problem and also use variance analysis to compare actual with budgeted figures and ensures corrective actions and also make forecast statements. Example: identifying potential causes of adverse sales, prices, volume variances etc. The management is concerned about the control mechanisms, timing, coordination, motivation and so on.

3 Argument in Favour of Traditional Budgeting

Experts argue that budget in itself is not a problem but that its application will determine whether it is useful or not in an organisation. Ekholm and Wallin (2000); Hansen, Otley and Van der stede (2003); Libby and Lindsay (2010), argue that the key element of management accounting is budgeting in most organisations. Nevertheless, its role in organisation has been trailed by criticism. While some argue that it is important, others see it as unnecessary distraction (Hope & Fraser, 2003a). Libby and Lindsay (2010) further researched the use of budgeting in organisation and its relevance and found that budget is still being used by many organisations regardless of widespread criticism that has trailed it by scholars.

3.1 Arguments against Traditional Budgeting

The criticism against traditional budgeting was vehemently argued by Hope and Fraser (2003b). They maintained that budgeting most often lead to dysfunctional behaviour among staff, consumes management's time, affects the flexibility and adaptability of organisation in any given business place. Axe *et al.*, (2009) argue that budget not only use up a considerable amount of organisation's time and resources but do not adjust to changes in a competitive business environment, hence making it obsolete and uninteresting. Gurton (1999) averred that budgeting is an old practice while Jensen (2001) and Wallander (1999) termed it 'broken' and 'gratuitous evil' respectively.

4 Alternatives to Traditional Budgeting

Rolling Forecast

The most common and the foremost alternative to traditional budgeting among organisations is the rolling forecast. This is a situation where budgeting is based on a monthly, quarterly or half yearly forecasting. (Ekholm & Wallin, 2000). According to Howell (2004), the process of budgeting should be taken as a primary consideration in an organisation's future. Rolling forecast provides a framework for an organisation to be able to see their future plan. It entails concrete, workable plan that updates the management on

the position of the organisation on a current basis. It provides an avenue for an organisation to be able to make an estimation of a likely event in the future of an organisation. Gurton (1999) averred that the essence of a rolling forecast is to provide a picture of the real situation in the organisation. The forecast according to him can be created for any period of time and subsequently updated as new events crop up. The tendency is to reflect on the previous forecast whenever a new forecast is made. The opportunity to compare the outcome of the previous year with the future expectations provides the potential for organisation to point out values for the past period including the last forecast and the current one. Example, in a big manufacturing firm, a rolling forecast of next financial year with 5 periods of actual result will have 5 periods of forecast data into the year.

Accrual Budgeting

This is simply the application of accrual basis of accounting in budgeting process (Linder & Jones, 2003; Marti, 2013). It brings back the accrual method of accounting where revenues and liabilities are recognised when it is earned and incurred not when cash is received or payment made for them. Schick (2007), says that traditional budgeting matches budgeting and financial reporting together, making it possible to report on accrual basis and budget on cash basis. Example, value of goods received, not invoiced before the end of the fiscal year would be part of the expenses for the year it was received.

Performance Budgeting

There is no generally accepted definition of performance budgeting. However, Kong (2005), averred that it is the inclusion of performance driven measures in the process of budgeting. This is sometimes called activity-based budgeting, result based budgeting, entrepreneurial budgeting or outcome-based budgeting. Schick (2007), defines it as a system in which increment in resources leads to a subsequent increment in result. He says it is an analytical tool (used to inform the policy makers) in a broad sense and decision rule in a strict sense. This could be compared to incremental budgeting mostly used in Nigeria where a yearly increment is made to an existing or previous years' budget to represent the budget for the current or future year. Others include Zero based budgeting where budget is built from scratch.

Not Budgeting at all is also an alternative to traditional budgeting in view of the researchers. This is in line with Hope and Fraser (2003b); Axe *et al*, (2009); Gurton (1999) and Jessen (2009) and Wallander (1999), who did not support budgeting. Other alternatives of traditional budgeting in private life include, the bucket list, back to book camp and stick it to yourself theories etc.

4.1 Advantages and Disadvantages

Anthony and Govindarajan (2007) maintained that the rolling forecast provides unusual flexibility that traditional budgeting lacks and that it provides an avenue for a follow up that is not strict like traditional budgeting. Another advantage is that the information is regularly updated which removes obsolescence and provides easy follow up in the development of the organisation. However, budgeting is not without some disadvantages. It follows a set rule from preparation to implementation. Because of the critical nature of budgeting to the success of any target especially by an organisation, it most times follows a bureaucratic process to ensure a proper identification of the sources of income and the expenditure to match it. This follows a series of examination and sometimes budget defence which could

be time and energy consuming (Hope and Fraser, 2003b). Though rolling forecast is touted as being flexible, its frequent changing nature makes it difficult for managers to understand. It provides some form of uncertainty with managers in the organisation because of its dynamic nature.

5 The Influence of Organisational Culture

Brownell (1982); Brier and Hirst (1990) in their review of budgetary system found that conditional features in organisations has the power to sway the preferable style of leadership and the impact of participation on the performance of the subordinate. Study of international managers in Europe alone shows that subordinates who participated in the budgetary process but has unfavourable performance record did not manifest ill feeling towards their supervisors as long as they were part of the process that was used to evaluate them (Magner, Welker & Campbell, 1995). A number of academic scholars have conducted researches on the influence of organisational culture which these studies above have supported including the organisational cultural dimensions and the influence on the importance of budget emphasis by the supervisors. Many organisational, environmental and interpersonal factors directly and indirectly affect the relationship that exists between a certain level of an organisation and the performance of a subunit (Richardson, Vanderberg, Blum & Roman, 2002). Hopewood (1972) averred that budget constrained style compared with profit constrained style of budgeting gave rise to a more stress and resulted in hostility towards supervisors. He maintained that budget constrained supervisors are prone to not meeting their budget target and the likelihood is to falsify it. Dunk (1990) holds that besides the good behavioural result from the use of budget, which includes performance measurement and motivation, there has been an overwhelming focus on the dysfunctional consequences like the creation of slack. This is in line with the view of Bratton and Gold (2007); Busch and Gustafsson (2002); Onsi (1973) and Ozer and Yilmaz (2011). Onsi (1973) who averred in his work on examination of budget performance and its usefulness, that it would be important to note the nature of budget slack and behavioural factors that affect the budgetary system. Creation of slack in the budget has been identified as an adaptability feature that helps organisation to absorb the pressure from the need to maintain inflow of resources for meeting budgetary targets (Ajibola & Akinniyi, 2013). Organisational culture that supports this creativity and emphasizes on adaptability is expected to place less emphasis on meeting budget target and see slack as a veritable mechanism to arrest the environmental changes, however, the ones that lay more emphasis on tight controls will be expected to have its budgetary slack level reduced since control system gives more, hence according to Anthony and Govindarajan (2007), control system provides more information to senior staff and increases the ability of top management to detect slack.

6 Conclusion and Recommendation

The assertion by Gurton (1999), Jensen (2001) and Wallander (1999) that Budgeting is 'obsolete', 'broken' and 'gratuitous' respectively cannot be vehemently substantiated, even as humans, budget is needed to form operational guidelines, control excesses, pursue targets and spend within means as established in this work. Traditional budgeting is the panacea

for enforcement of control. Budgeting builds extensive planning, coordination and motivational spirit and tends to encourage hard work in an organisation. Drawing from Libby and Lindsay (2010); Ekohlm and Wallin (2000), budgeting is central to any organisation and pivotal to managerial successes in most organisations. In other words, budgeting is highly recommended in any business environment because it helps organisations to define objectives, remain focused and pursue targets. It is pivotal to business success and establishes standard to be followed in successive business transactions.

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