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# BUDGETING PRACTICE AND ORGANISATIONAL STRUCTURE

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### Key findings:

- The 'beyond budgeting' movement, which emerged in the 1990s, advocates that companies could improve their performance by abandoning budgeting altogether.
- The findings of this research are very different from the assertions of those who favour 'beyond budgeting' and who claim that managers are very dissatisfied with budgeting systems.
- Analysis of the survey data supported the long-held view that managers are likely to be more satisfied with budgets in relatively stable environments, especially those with a high degree of task certainty.
- Decentralisation might be attractive and it is essential for the 'beyond budgeting' theory to work in practice.

### Overview of project

This report summarises an investigation into budgeting practices in UK companies. The research stemmed from debates generated by the 'beyond budgeting' movement that emerged in the 1990s. The research was sponsored by CIMA, the Chartered Institute of Management Accountants.

Business budgeting developed in the 1920s and has been subject to various criticisms over the last 70 years. However, it was generally accepted that budgeting was a necessary evil, and that its benefits outweighed its costs. This view was challenged by the 'beyond budgeting' movement, whose advocates suggested that companies could improve their performance by abandoning budgeting altogether.

The report is divided into two parts. In the first part, the authors review the development of budgeting practices, how budgets are used and the problems that can result

from budgeting. A survey of management attitudes to budgeting is reported here and forms a major part of the report. The survey involved a number of companies in the South West of England. The main aim of the survey was to discover whether the 'beyond budgeting' critique had affected attitudes to budgeting and whether budgeting practices had changed in recent years as a result. The attitudes of both financial and non-financial managers were investigated.

Part two of the report reviews the relevant literature relating to budgets and organisational structure. It includes a field study based on interviews with financial controllers, directors and operational managers from several of the survey companies. Findings from this study also form a key part of this report.

The purpose of the field study was to check the survey results and to gain additional insights into contemporary budgeting practice. Visits were made to eight of the companies that had participated in the survey, and

**Table 1: Survey companies**

Business	Ownership	Structure
Aerospace	Part of aerospace multinational	Cost centre
Food ingredients manufacture	Irish group listed on Irish stock exchange	Corporate
Construction	Part of UK construction group	Profit centre
Frozen food manufacture	German private company	Profit centre
Food manufacture	Part of large UK food group	Profit centre
Plastic and glass product manufacture	Part of South African diversified group	Cost centre
Systems engineering	Private UK-based company	Profit centre
Wholesale, retail and leisure	Private UK-based company	Profit centre

interviews were held either with a finance manager or with both finance and non-finance managers. A semi-structured interview style was used which allowed the interviews to be directed, yet still allowed the interviewees to introduce their own topics.

The report ends with conclusions about budgeting, organisational structure and the 'beyond budgeting' thesis.

### Objectives

- A budgeting survey to (i) test whether the views of the 'beyond budgeting' movement to abandon budgeting are shared by managers in practice, and (ii) to discover whether the 'beyond budgeting' critique had affected managerial attitudes to budgeting and whether budgeting practices had changed in recent years as a result.
- A field study to confirm the findings of the budgeting survey and to provide more insight into the changing uses of budgeting.

### Main findings and their implications for practical application

This section covers the findings of the survey on management attitudes to budgeting and also the field study based on interviews with financial controllers, directors and operational managers.

### Managerial survey findings – budget preparation

The attitudes of both financial and non-financial managers were investigated and a 40.1% response rate was achieved.

All 40 respondents confirmed that their companies set budgets. Most companies started their budgeting process four to six months before the start of the financial year. Budgets are usually set for each month in the financial year and the vast majority of managers confirmed that variances between budget and actual results are reported monthly. Most companies also provided previous year data for comparison.

### Attitudes to budgets

About 95% of financial managers thought that budgets are fairly, very or extremely important, especially for performance evaluation, control and planning. In addition, managers considered that budgets are also important for co-ordination, communication and

authorisation. However, respondents tended to disagree that budgets are important for motivation.

Most financial managers disagreed with the statements criticising budgets. A majority of financial managers agreed or strongly agreed with only two (from 20) of the critical statements. Overall, these results do not indicate widespread dissatisfaction with budgets and budgeting processes in the survey companies.

There were almost no significant differences between the responses of financial and non-financial managers to statements about the importance of budgeting and to statements criticising budgeting. The only significant result concerned the time-consuming nature of budgets, their realism and the need for more budgeting resources. Financial managers tended to agree that budgets are too time-consuming, while non-financial managers were more likely to regard budgets as unrealistic and to argue for more budgeting resources.

Most respondents were not critical of the budgeting process, but some were. There were three causes:

1. The 'top-down' nature of the processes that could lead to lack of local ownership.
2. A lack of accountability or involvement of operating managers.
3. The need for a better budgeting process.

When asked directly, a significant minority of managers expressed some dissatisfaction. However, the issues raised did not relate to an over emphasis on accounting measures, the budget constrained style of management, target setting or budget gaming. Instead they were concerned with the budgeting process and the roles of both top managers and operating managers in budgeting.

### Changes in the budgeting process

More than half (55%) of the respondents reported some form of change in the past five years. Three general themes emerged:

- greater involvement of junior management in budgeting processes,
- more detailed analysis,
- intensification in the use of budgets.

Traditional budgeting methods are not declining in importance – one question indicated that their use in setting bonuses was increasingly important. Change in the past five years had not been driven by the 'beyond

budgeting' movement; in fact respondents reported more sophisticated traditional budgeting and, in some cases, tighter financial controls.

There was also evidence that non-financial performance indicators and the balanced scorecard had recently grown more important, together with greater emphasis on standard costing and variance analysis.

### Field study findings: budget preparation

The field study confirmed the findings of the survey. Typically, budget preparation begins three to six months before the financial year and follows a carefully structured process. 'Ownership' of the budget by responsible managers was found to be important in most of the field study companies. It was generally recognised that budgeting was time consuming and expensive and two companies had taken action to reduce budget preparation time. The sometimes longwinded nature of the budgeting process did not automatically lead to dissatisfaction, although the interventions of senior managers were criticised in two companies.

### Field study findings: budgets for influencing and controlling behaviour

Budgets are used for control in all eight companies. In two companies, the managing director sets what might be termed a 'budget constrained' culture. In a profit centre organisation, this has led to some workplace tensions. However, in a cost centre organisation, managers seemed to accept the need for stringent targets and cost control. (It may be the case that aggressive targets in a more stable, cost centre environment are more acceptable). These two companies faced personal constraint, enforced by individuals. In contrast, a large cost centre faced bureaucratic constraint with complex systems and senior managers involved in detailed reporting.

The profit centre managers tended to emphasise managerial responsibility rather than control. In two companies interviewees stressed the need to educate managers to take action, even if this involved unbudgeted spend. At one of the food manufacturing companies managers were caught between corporate managers who insisted on aggressive targets and a local culture that emphasised teamwork and supportive budgeting.

### Field study findings: attitudes to budgeting

In the survey, most respondents saw budgeting as important and the field study confirmed this. Budgeting was described as 'essential', 'pretty important' and the 'primary financial tool'. It 'provided a framework', 'crystallised targets' and allowed 'management by exception'. Although there were some negative comments, as in the survey, these were outweighed by generally positive comments.

The field study, like the survey, found that where dissatisfaction was expressed, this was usually due to the process rather than the principle of budgeting. Poor processes included the failure to encourage local ownership of budgets, and senior management pressure. In two companies, budgets were considered long-winded and local budget ownership was an issue. In both these companies and at one of the food manufacturers, the intervention of senior managers was not always seen as helpful.

### Implications for 'beyond budgeting' and traditional literatures

The field study confirmed that budget processes tend to be long-winded and bureaucratic, although this did not automatically lead to dissatisfaction. Two companies had reduced the length of time given to budget preparation.

There was little evidence that budgeting fails to meet the needs of managers in competitive environments. In general, budgeting was seen as helpful for planning and control.

Similarly, there was little evidence that performance contracts are undesirable, although incentive schemes had real and sometimes unwanted effects. There was evidence in two companies that budgets might be 'managed' with an eye on potential bonuses, while, at another company, the combination of budget targets and an incentive scheme was criticised.

Only one company provided an example of a budget constrained style which had adverse consequences. In most companies, management style would have been characterised as more 'profit conscious' than 'budget constrained'.

There was little evidence of conflicting objectives in setting budget targets. There was some evidence of aggressive targets being imposed by senior managers in two companies but, generally, companies seemed to set realistic, but still challenging, budgets.

### Case study

A case study was undertaken at a Finnish company specialising in heavy drilling and rock moving equipment, to provide further insight into attitudes to budgeting. It is part of a Swedish group, listed on the Swedish stock exchange and operating in 130 countries. The group has a turnover of £7.8 billion and 40,000 employees.

Initially, the management gave the impression that it had been influenced by 'beyond budgeting'. However, the finance director seemed to know little of the movement or its implications. He seemed content with the budgeting procedures in use and referred to 'intelligent use of the budget'. The company had 'intelligent pressure' for growth and this was transmitted through the budget.

Some changes had been planned, but these were confined to making the budgeting process slicker, placing more emphasis on rolling forecasts and introducing new methods such as the balanced scorecard.

The case study demonstrated that, rather than abandoning budgeting, the company had introduced new techniques such as rolling forecasts and a more integrated method of budgeting.

### Findings, particularly lessons learned from the research

Both the survey of financial and non-financial managers and the field study indicated that managers were largely satisfied with their budgeting systems. They regarded budgeting as important for a number of reasons and had a limited number of specific problems.

These findings are very different from the assertions of those who favour 'beyond budgeting' and who claim that managers are very dissatisfied with budgeting systems.

Analysis of the survey data supported the long held view that managers are likely to be more satisfied with budgets in relatively stable environments, especially those with a high degree of task certainty. The survey also indicated that in relatively certain environments, budgets tend to become more important for control, not for planning. Conversely, budgets become less important for control but more important for planning in a more uncertain environment.

It is likely that cultural change over the last 30 years has affected the use of, and attitudes to, budgeting. The majority of managers interviewed had a flexible attitude, agreed to listen to reasoned explanations and

adopted a team-based approach to problem solving. It was established that budgets could be long-winded and bureaucratic, but this was not necessarily a problem. Linking budgets and incentives could increase the risk of gaming but managers were very aware of these possibilities.

New technology and increased management education have encouraged more sophisticated techniques in budget preparation. In addition, budgeting has been integrated with non-financial measures in general and the balanced scorecard in particular. Instead of abandoning budgets as advocated by the 'beyond budgeting' movement, there seems to have been a move towards the (enlightened) use of budgeting.

### Lessons from the study – structure

Decentralisation might be attractive and it is essential for the 'beyond budgeting' theory to work in practice. However, it might impact on different tiers of an organisation in different ways, some of which may not be practical or desirable. Organisations combine profit centres, cost centres and product/service transfers between these centres in a number of ways, depending on the different products and markets.

In four field study profit centres, it was seen that profitability was driven down to sub-units and value is added by these market facing units.

The study concluded that business units tend to use structures that recognise the major value-adding parts of the business. Revenue is usually attributed to value-adding units, either directly or at 'arm's length' transfer prices. Centres that are not key value adding units tend to be designated cost centres and their outputs are transferred on some cost related basis to the value-adding units.

### Lessons from the study – co-ordination

Supporters of 'beyond budgeting' see radical decentralisation as a crucial part of the cultural change that abandoning budgeting demands. However, the field study companies need co-ordinating mechanisms either between business units or within the business unit. The study concluded that business complexity sets limits to sensible decentralisation and the degree of autonomy varies, depending on organisational level.

### Lessons from the study – control

If budgets are used to pressure managers, then unfortunate consequences may occur. However, the study found more examples of the constructive use of budgets with little evidence of problems in most

of the survey companies. One company probably had a 'traditional' approach to budgeting and the budget was an instrument of tight control in this company. Nevertheless, as a cost centre producing a standard product, it was hard to say that the use of standard costing and tight budgets was inappropriate.

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