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Budgeting: Perspectives from the Real World

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A SURVEY OF SENIOR ACCOUNTING AND FINANCE MANAGERS EXAMINES THE BUDGETING PROCESS AT FOR-PROFIT COMPANIES, INCLUDING THE USEFULNESS AND PERCEIVED VALUE OF THE PROCESS, USERS' SATISFACTION WITH IT, AND THE IMPEDIMENTS AND CHALLENGES TO BUDGETING.

The value of the budgeting process has been the subject of intense debate over the past few years. In their 2003 book, *Beyond Budgeting*, Jeremy Hope and Robin Fraser suggest that the traditional budgeting process is outdated and dysfunctional and, therefore, should be abandoned.[1] Alternatively, a 2007 survey by Theresa Libby and R. Murray Lindsay offers evidence that senior accounting and finance managers find the budgeting process to be more helpful than harmful overall and that there is a perception that operating managers could not function well without budgets.[2]

The Libby and Lindsay study provides answers to some important, but general, questions regarding the budgeting process, including whether accounting and finance managers' organizations planned to abandon budgeting and whether respondents agreed with some of the major criticisms of the budgeting process.

We conducted a follow-up survey to the Libby and Lindsay study with the goal of providing answers to some more-detailed questions:

- How are budgets in modern (for-profit) organizations prepared? That is, what are the descriptive characteristics of the budgeting process as used today?
- Does budgeting add value for organizations? If so, how?
- How satisfied are finance and accounting managers regarding the role that budgets play within an organization?
- What are the primary behavioral consequences, both positive and negative, of using budgets?
- What is the relationship, if any, between budgets and other management processes—i.e., are they integrated in any meaningful sense?

The Survey

In November 2007, questionnaires were sent via e-mail to 29,501 members of the Institute of Management Accountants (IMA®) who, based on job title, were likely involved in the budgeting process. These members included general management, corporate management, public accounting, general accounting, cost accounting, and environmental accounting staff members. Participants were asked to respond to questions based on their position in the organization (i.e., "company-level" or "segment-level," where "segment" was defined variously as a subsidiary, division, department, or product line).

A total of 815 members completed the survey. Because the focus of our study was *for-profit* entities, as with the Libby and Lindsay study, we excluded responses from managers at nonprofit or governmental entities. This resulted in a final sample of 720 respondents who worked at publicly traded corporations (52.5%), privately held corporations (42.4%), and partnerships (5.1%), mostly in the United States.

Approximately 48% of respondents work at the corporate level, with the remainder at the segment level. The highest percentage of respondents was in manufacuturing (28.1%), followed by healthcare (9.9%). In regards to company size, the largest percentage of respondents (35.7%) reported company revenues between $1 billion and $50 billion and segment revenues between $50 million and $500 million (34%). The largest group responding to our survey was controllers (25.5%). On average, our respondents had 13 years of budgeting experience.

Descriptive Characteristics of the Budgeting Process

The initial part of the survey instrument asked for descriptive information regarding the budgeting process at the respondent's organization. Specifically, we wanted to know how budgets were developed and how they were used for planning and control purposes.

According to 69.2% of respondents, the development of the budget is accomplished via a *negotiated process* (a combination of "top down" and "bottom up"). Further, 85% of respondents stated that this process was the same throughout the entire company, with exceptions due to merger/acquisition activity or international operations. These results are roughly consistent across the two groups of respondents, corporate and segment.

In terms of planning, 69.5% of respondents indicated that the primary planning tool continues to be the *static budget*, defined as a budget valid for only one planned volume level of activity for the upcoming budget period. By definition, the static budget provides scant opportunity to adapt quickly, so it is interesting to learn that the majority of respondents continue to use the static budget given the available options for planning purposes, such as continuous or rolling budgets, flexible budgets, and zero-based budgets (ZBB).

Regarding feedback/control purposes, most respondents compare actual results to budgeted results on a *monthy* basis using both financial (primarily revenues and expenses) and nonfinancial measures (primarily customer satisfaction and market share). Moreover, 78% of respondents reported that managerial compensation plans, including incentive compensation formulas, incorporate achievement of specified budget objectives for *financial* performance measures, while 62.7% reported the same for *nonfinancial* measures.

All of these results are generally consistent between corporate- and segment-level respondents.

The Usefulness and Value of Budgeting Systems

The next part of the survey asked respondents for their opinions regarding the *usefulness* of budgeting systems in relation to specific business objectives: strategic planning, resource/operational planning, operational control, communication, coordination/teamwork across subunits, coordination/teamwork across functional areas, motivation, and incentive rewards determination. This list of objectives parallels what we traditionally teach in managerial and cost accounting courses.

As noted in Table 1, Panel A, the majority of respondents believes that the budget is either "useful" or "very useful" as it relates to the list of business objectives. In a traditional management accounting setting, the budget was considered to be important for planning and control purposes only. The fact that these preparers indicated that it is also useful for other functions such as strategic planning, communication, and incentive rewards suggests that there may be a forward-looking

Table 1: Perceived Usefulness of the Budget

Panel A: Aggregate Results

Business Objectives	Very Useful/ Useful	Somewhat Useful	Not Very Useful/Not Useful	Don't Know/No Opinion	N
Strategic Planning[1]	60.0%	24.4%	10.5%	5.1%	488
Resource/Operational Planning[2]	73.5%	18.7%	3.9%	3.9%	487
Operational Control[3]	84.3%	10.1%	4.1%	1.4%	485
Communication[4]	69.9%	19.0%	8.7%	2.5%	485
Coordination/Teamwork across Subunits[5]	51.4%	21.6%	21.4%	5.6%	486
Coordination/Teamwork across Functional Areas[6]	53.3%	23.5%	19.1%	4.1%	486
Motivation[7]	58.8%	24.0%	14.1%	3.1%	483
Incentive Rewards Determination[8]	68.1%	14.9%	11.8%	5.2%	483

Panel B: Corporate and Segment Subgroups

Business Objectives	Very Useful/Useful	
	Corporate Responses	Segment Responses
Strategic Planning	50.7%	54.5%
Resource/Operational Planning	76.1%	73.0%
Operational Control	86.1%	85.5%
Communication	69.1%	70.5%
Coordination/Teamwork across Subunits	52.8%	49.4%
Coordination/Teamwork across Functional Areas	53.3%	54.5%
Motivation	56.6%	56.9%
Incentive Rewards Determination	70.1%	67.9%

NOTES:

1 To support strategic initiatives specified by top management.
2 To estimate resources required for forecasted operations or to anticipate financing needs.
3 To ensure that actual results are consistent with planned results; to provide feedback/assessment regarding operating activities.
4 To provide a road map for employees to deliver output/services as expected by management; to communicate how individual units of the organization contribute to the overall strategy.
5 To encourage teamwork across business *segments* (divisions, product lines, etc.).
6 To encourage teamwork across business *functions* (finance, marketing, systems, etc.).
7 To encourage employees to put forth effort in terms of stated goals and objectives of the organization.
8 To determine bonuses or other benefits based on comparison of actual vs. budget.

movement from relying solely on the annual numbers as a planning and control mechanism to a perception that the budget can be part of the strategic management process of an organization.

While many respondents indicated the budget is useful for all of the listed objectives, there were some for which more than 10% of respondents indicated that the budget process is either "not very useful" or "not at all useful": coordination across subunits (21.4%) and functional areas (19.1%), motivation (14.1%), and incentive rewards determination (11.8%). As such, these areas represent fruitful topics for additional research or critical examination into the reasoning behind these perceptions.

The perceived usefulness of the budgeting process does not vary much based on whether respondents are at the corporate or segment level. One difference, as seen in Table 1, Panel B, is that segment-level respondents

Table 2: Respondent Satisfaction with the Budgeting Process

Panel A: Aggregate Results

Business Objectives	Satisfied/ Very Satisfied	Neutral	Dissatisfied/ Very Dissatisfied	Not Applicable	N
Strategic Planning	49.2%	27.7%	21.6%	1.5%	459
Resource/Operational Planning	55.8%	24.1%	17.9%	2.2%	457
Operational Control	64.9%	18.3%	15.9%	0.9%	459
Communication	49.5%	27.1%	21.9%	1.5%	457
Coordination/Teamwork across Subunits	35.5%	33.6%	27.2%	3.7%	459
Coordination/Teamwork across Functional Areas	41.8%	31.9%	24.6%	1.8%	455
Motivation	43.0%	32.1%	24.0%	0.9%	458
Determination of Incentive Rewards	45.7%	26.3%	22.8%	5.3%	457

Panel B: Corporate and Segment Subgroups

	Satisfied/Very Satisfied	
Business Objectives	Corporate Responses	Segment Responses
Strategic Planning	43.1%	44.2%
Resource/Operational Planning	53.5%	52.5%
Operational Control	59.2%	62.8%
Communication	41.1%	45.8%
Coordination/Teamwork across Subunits	28.5%	32.2%
Coordination/Teamwork across Functional Areas	37.8%	40.2%
Motivation	33.8%	38.0%
Determination of Incentive Rewards	41.1%	44.0%

perceive the budget to be more useful as it relates to strategic planning, yet corporate-level respondents indicate greater usefulness in terms of resource/operational planning. Corporate-level respondents also perceive the budget to be more useful for coordinating across subunits as well as a tool for incentive rewards determination.

Respondents also were asked to denote their *level of satisfaction* with their organization's budgeting system as it relates to the list of management objectives. Satisfaction ratings for the full respondent sample are presented in Table 2, Panel A. More than 40% of the respondents are largely satisfied with the budgeting process except in relation to coordination/teamwork across business units. Operational control was cited as the one objective (or benefit) of budgeting where individuals are most satisfied. This finding is not surprising given that operational control is one of the classic purposes for preparing and using budgets.

One other observation from Table 2, Panel A, is that more than 10% of respondents are *not* satisfied with the budgeting process. This disparity between the usefulness of budgeting in general compared to increased dissatisfaction within a specific organizational context suggests that some of the respondents feel that the budgeting process within their respective organization is not optimal and possibly does not produce the kind of results they feel are possible.

Table 2, Panel B, shows that segment-level respon-

Table 3: Impediments/Challenges Associated with the Budgeting Process

- Unrealistic goals set for the budget
  - Problems linking the budget with the strategic plan
- Lack of accountability by some managers
  - Lack of buy-in by nonaccounting managers
  - Amount of "fluff" built into the budgets ostensibly because of the reward system
  - Tendency of some managers to shirk their responsibilities in terms of budget preparation
- Changes in product mix during the budget period
- Changing costs during the budget period
- Accuracy of budget estimates
  - Revenue planning is inadequate
- Lack of resources in terms of time, staff, and a system to create the budget
  - Initial budget time is too time-consuming
  - Rework cycle time is too time-consuming
- Inability to correctly prioritize for planning
- The politics and culture of the firm
  - Silo attitude adopted throughout the firm
  - Lack of communication and information sharing across firm
  - Diverse management and geography
  - Reorganizations that create budgeting conflicts
- Constraints due to economic changes, market conditions, or the regulatory environment

dents are relatively more satisfied with the budgeting process than are corporate-level respondents, with one exception: Corporate respondents are more satisfied with the budget as it relates to resource and operational planning. The difference for this attribute, however, does not appear to be substantial.

It is no secret that the accounting/finance function today is being challenged to provide greater value-added services to the organization. Consequently, we asked accounting/finance managers about the value that was added to the organization as a result of their respective budgeting process: "Increasingly, the accounting/finance function is being challenged to provide value-added services to management. How would you rate your budgetary process in terms of adding value to your organization?" Forty percent of respondents feel that the budgeting process meets this overall goal.[3]

At the same time, approximately 23% of respondents believe that the budgeting process adds *relatively little value* to the organization. This result is being driven more by the segment accountants—29% of them held this view. The difference between these results and the usefulness and satisfaction ratings reported in Tables 1 and 2 are somewhat puzzling. One possible explanation is that respondents were applying a cost-benefit test when judging "value added." Another possibility—and possible limitation of the study—is that the term "value added" may mean different things to different respondents.

A clue to resolving the inconsistency in results is provided by the open-ended responses to the question: "What impediments/challenges exist that affect the ability of an organization's budgetary process to add value to the firm?" Responses lend support to concerns being raised by critics of budgeting and simultaneously suggest strategies for improving the budgeting process. While some of our survey respondents indicated there were no problems associated with the budgeting process at their organization, a number of common concerns were identified. They are summarized in Table 3. In particular, challenges and impediments focus on unrealistic goals, management accountability, lack of or constrained resources, and the political climate surrounding the firm.

Behavioral Consequences of Budgeting

We also sought practitioner perceptions regarding the behavioral consequences (both positive and negative) associated with the use of budgets. A listing of putative negative behavioral effects (e.g., "budgets pressure employees to achieve results") and summary response data from the sample is provided in Figure 1.

Respondents largely believe that budgets *do not*:

- Block employee initiatives,
- Unduly pressure managers to make decisions with a short-term focus,
- Inhibit management responses to change,
- Unnecessarily pressure employees to achieve targets, or
- Inappropriately reward those skilled in the negotiating process.

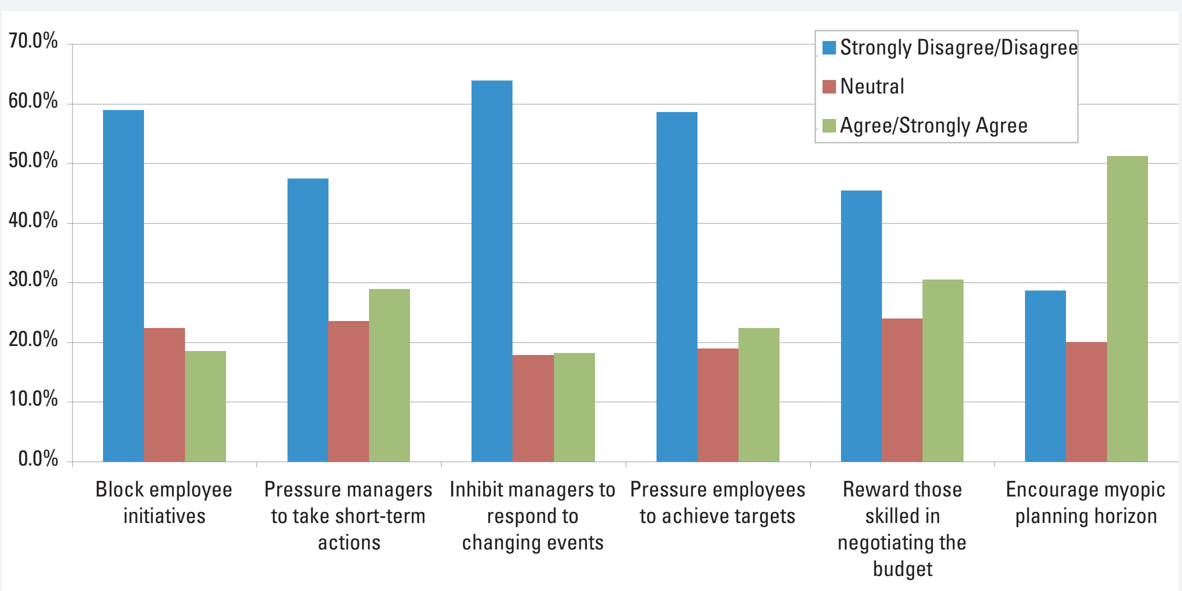
One attribute where the responses might be of concern is the perception that the budgeting process encourages a *myopic planning horizon*. Clearly, this sentiment suggests that some organizations need to pay greater attention to linking budgeting to strategy.

In terms of the breakdown between corporate- vs. segment-level respondents, segment-level respondents indicated a stronger sentiment with the issues presented in Figure 1. Compared to corporate-level respondents, more segment-level managers either agreed or strongly agreed that the budget:

- Blocks employee initiatives,
- Pressures managers to make decisions with a short-term focus,
- Inhibits management response to change,
- Pressures employees to achieve targets,
- Inappropriately rewards those skilled in the negotiating process, and
- Encourages a myopic planning horizon.

In fact, almost twice as many segment-level employees than corporate-level employees felt that budgets had negative behavioral consequences in terms of employee initiatives, motivating short-term decision

Figure 1: Negative Behavioral Consequences of Budgeting



making, and pressure to achieve targets.

Figure 2 presents perceived *positive* behavioral effects of budgeting. There was general agreement among respondents that budgets can be used to support continuous improvement, to provide managers with information they need to respond to change, to motivate information and knowledge sharing across subunits, and to encourage appropriate risk taking.

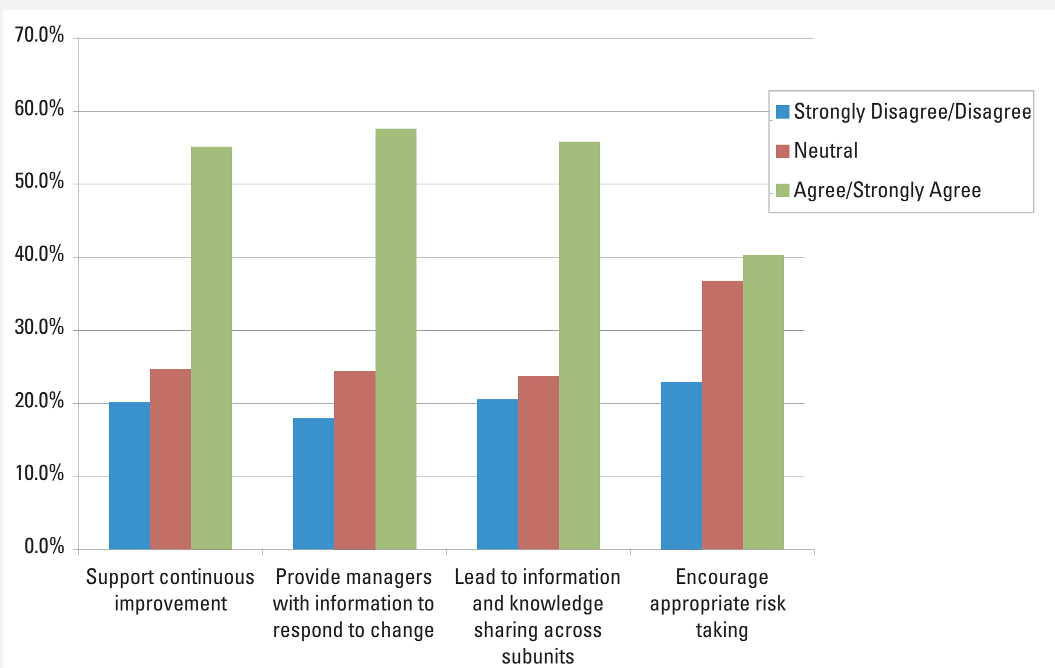
For either the "agree" or "strongly agree" responses, a lower percentage of segment managers (details not reported here) indicated that budgets can be used to support continuous improvement and motivate information and knowledge sharing across subunits. These subgroup results, combined with the subgroup results associated with Figure 1, suggest that there is more support for the budgeting process as a value-added proposition at the corporate level compared to the segment level.

Relationship between Budgeting and Other Management Practices

A budget that is a part of a firm's strategic planning process would likely be integrated with other management practices. To explore these relationships, we asked respondents whether their company (or subunit, as appropriate) used any of the following: activity-based costing (ABC), target costing, supply-chain management, or the balanced scorecard (BSC). Respondents were also asked if those individual practices, if employed, were integrated into the budgeting process.

The most frequently used practices were supply-chain management and the balanced scorecard, both of which are linked to the budgeting process when used. Approximately one-third of respondents' organizations use ABC as a management tool, with approximately 75% integrating it with budgeting. Slightly greater than one-third of respondents' organizations reported the use

Figure 2: Positive Behavioral Consequences of Budgeting



NOTES:

[1] Jeremy Hope and Robin Fraser, *Beyond Budgeting: How Managers Can Break Free from the Annual Performance Trap*, HBS Press: Boston, Mass., 2003.

[2] Theresa Libby and R. Murray Lindsay, "Beyond Budgeting or Better Budgeting?" *Strategic Finance*, August 2007, pp. 46-51.

[3] We stress again the point that our respondents work in accounting/finance—i.e., "preparers" of information. Therefore, there may be some positive response bias because of the nature of the sample.

of target costing—77% of which link target costing to the budgeting process. In short, responses indicate some evidence that managers perceive the budgeting function as capable of being integrated with modern management practices.

Future Research

Our study provides an up-to-date, real-world look at budgeting practices at a sample of U.S. profit-seeking organizations. It updates and extends the recent study by Libby and Lindsay. In particular, we provide descriptive information about current practices in budgeting as well as the perceptions of seasoned individuals as to the behavioral consequences of budgeting and the value of budgeting vis-à-vis a set of business objectives.

The research done here can be extended in several ways. Both our study and that of Libby and Lindsay obtained survey evidence from accounting/finance managers. An obvious extension to both studies would be to survey operational managers (i.e., "users") to determine the extent to which their views are consistent with the views of finance/accounting personnel. Another direction for future research would be to examine the statistical relationship between budgeting practices and financial performance variables (e.g., stock price or stock returns). Such a study could provide evidence as to the market's perception of different budgeting practices.

In addition, while the present study focused on profit-seeking companies, a future research project could focus on the perceptions of managers (both preparers and users) from the not-for-profit sector, including those from healthcare. Further, some level of dissatisfaction regarding the value added from the budgeting process was noted by respondents to our survey. Thus, future research is needed to determine reasons for this dissatisfaction, the context in which such dissatisfaction occurs, and recommendations for change/improvement. Finally, there are some firms that have moved away from the budgeting process as it is commonly construed. A study to determine conditions under which such a move is tenable would contribute greatly to our knowledge of the budgeting process. ■

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Endnotes

1 Jeremy Hope and Robin Fraser, *Beyond Budgeting: How Managers Can Break Free from the Annual Performance Trap*, HBS Press: Boston, Mass., 2003.

2 Theresa Libby and R. Murray Lindsay, "Beyond Budgeting or Better Budgeting?" *Strategic Finance*, August 2007, pp. 46-51.

3 We stress again the point that our respondents work in accounting/finance—i.e., are "preparers" of information. Therefore, there may be some positive response bias because of the nature of the sample.