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**Edward Nowak**

**Ruslan Motoryn**



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**Maciej Norkowski**

Wrocław University of Economics

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## **THE BEYOND BUDGETING CONCEPT AND MULTIFACETED CRITICISM OF TRADITIONAL BUDGETING**

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**Summary:** The main goal of this paper is to give an insight into the Beyond Budgeting concept and present a high level view of traditional budgeting's multifaceted criticism. According to the Beyond Budgeting Round Table (cross-industry collaborative research program), the changing business environment forces companies to question the effectiveness of their management tools and techniques, such as traditional budgeting. The perception that traditional budgeting is expensive and fundamentally flawed contributed to the development of the Beyond Budgeting concept. It is based upon twelve principles (that encompass adaptive processes and radical decentralization) and it leverages innovative management tools' capability of creating shareholder value.

**Key words:** Beyond Budgeting, Beyond Budgeting Round Table, budgeting.

### **1. Introduction**

Traditional budgeting has been subject to criticism in the economic literature for a long time. However, in the late 1990s the criticism became even more intense due to the initiation of research program called Beyond Budgeting Round Table (BBRT). It was set up by J. Hope and R. Fraser together with Consortium of Advanced Management, International (CAM-I). Its mission includes "transforming management models to enable sustained high performance in turbulent conditions" [www.bbrt.org]. The main rationales behind the BBRT's inception were connected with the founders' long held view that budgeting is fundamentally flawed and the outcome of initial research pointed to successful organizations that operated without traditional budgets or used them in a different way [Hope, Fraser 2003, p. xiii].

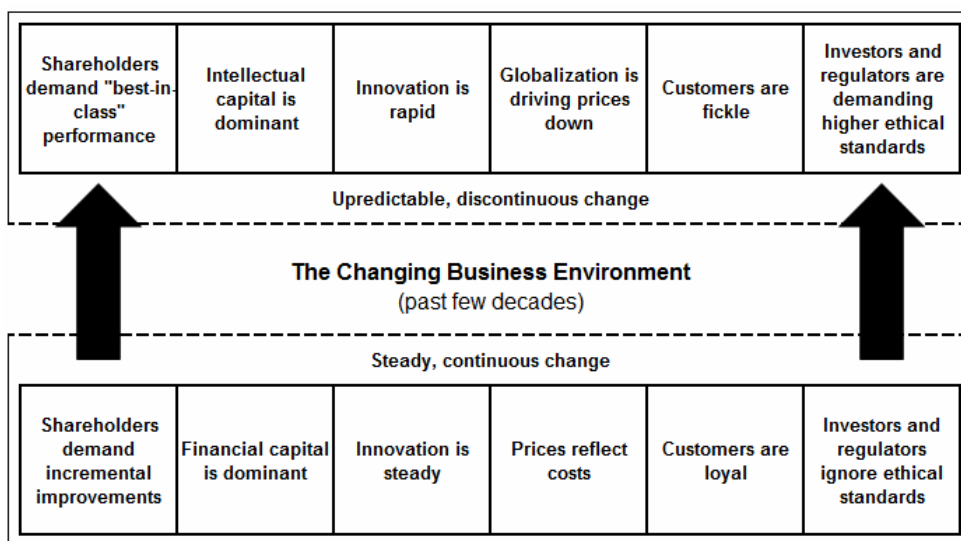
Budgeting was introduced in the 1920s in large organizations, such as DuPont, General Motors, ICI, and Siemens, and was initially used for managing costs and cash flows [Hope, Fraser 2003, p. 9]. Since that time it has become one of the most popular methods for managing a business and has had a long history of its

successful applications. Therefore, the radical criticism aimed at budgeting divided both scientific community and business practitioners. In result, at least three tendencies emerged in this field: a tendency to improve traditional budgeting, a tendency to use activity-based or multidimensional budgeting and a tendency to go Beyond Budgeting [Szychta 2008, p. 410].

J. Hope and R. Fraser define Beyond Budgeting as an alternative management model based on the decision-making needs of front-line managers. Furthermore, they define it as a coherent set of alternative processes that support relative targets and rewards, continuous planning, resources on demand, dynamic cross-company coordination and a rich array of multilevel controls. Implementing the concept allows transferring performance responsibility from the center to business units and, in more mature cases, to the front line. The heightened sense of ownership and commitment that comes from involving local people in setting goals and actions provides the driving force for continuous improvement [Hope, Fraser 2003, p. xix].

## 2. Multifaceted criticism of traditional budgeting from BBRT

According to BBRT, the global changes that took place in the economy in recent decades forced companies to redefine their business objectives as new determinants of survival emerged. Shareholders demand that companies focus on outperforming competition rather than achieving absolute targets that are fixed for a year ahead.



**Figure 1.** The implications of the changing business environment

Source: author's own work on the basis of Hope, Fraser [2003, pp. 4–15].

Intellectual capital became one of the major drivers of shareholder value. Innovation became rapid due to the fact that product and strategy cycles had shortened. Globalization is driving prices and profit margins down, which forces companies to slash costs and reduce bureaucracy. Customers are no longer as loyal as in the past. Companies need to decentralize authority to enable front-line employees to respond to changing customer needs without having to consult every decision with their superiors. The financial scandals that resulted in the bankruptcy of such companies as Enron and WorldCom increased the importance of high ethical standards that are now required by investors and regulators.

**Table 1.** The criticism directed at traditional budgeting from J. Hope and R. Fraser

| Primary factors leading to high levels of dissatisfaction  | Description   |
|--|---|
| Budgeting is cumbersome and too expensive  | Budget preparation is a time consuming process that takes from four to five months on average to finalize it. Hence, the process is expensive and absorbs a considerable amount of senior executives' and financial managers' time. As far as setting budget targets and agreeing upon resources are concerned, the process involves long negotiations between a corporate center and business units that will be responsible for meeting budget goals. Budgeting capability of creating shareholder value remains questionable   |
| Budgeting is out of kilter with the competitive environment and no longer meets the needs of either executives or operating managers | Traditional budgeting is an outdated method for managing and controlling a business as far as the present unpredictable and dynamic business environment is concerned. Among many disadvantages, it does not allow managing and controlling intellectual capital (which became one of the major drivers of shareholder value). It also impedes innovation due to strict adherence to predetermined plans and cannot be effectively integrated with other management tools, such as the Balanced Scorecard   |
| The extent of „gaming the numbers” has risen to unacceptable levels  | Budget contracts (or so-called “fixed performance contracts”) commit managers to achieving an agreed-upon outcome usually within a year. In order to earn their bonuses, managers often make an effort to shape such contracts in their favor and take necessary actions later on. They are inclined to: <ul style="list-style-type: none"> <li>– negotiate the lowest possible targets and the highest rewards,</li> <li>– make their bonuses at any costs,</li> <li>– put sales targets above customers' real needs,</li> <li>– limit a flow of information within their company as a result of perceiving other teams as competition,</li> <li>– ask for more resources than they really need when negotiating budget targets,</li> <li>– spend all that is in their budget so as not to lose remaining resources,</li> <li>– explain adverse variances in their favor,</li> <li>– avoid providing accurate forecasts and sharing bad news,</li> <li>– meet budget goals but not exceed them,</li> <li>– refrain themselves from taking any risks and initiatives that are not included in their budget</li> </ul> |

Source: author's own work on the basis of Hope, Fraser [2003, pp. 4–15].

The traditional budgeting was tailored to the specific economic conditions from the past decades. However, according to the BBRT, it is not tailored to the conditions formed by the dynamic and turbulent information age, whose arrival fully exposed budgeting's weaknesses.

The criticism from J. Hope and R. Fraser focuses on three main factors leading to high levels of dissatisfaction with traditional budgeting (see Table 1).

The criticism directed at traditional budgeting from B. Bogsnes (current BBRT chairman) focuses on the key problematic areas of management practices.

**Table 2.** The criticism directed at traditional budgeting from B. Bogsnes

| Problematic areas             | Description   |
|-------------------------------|---|
| Trust                         | As far as traditional budgeting is concerned, there is a fundamental lack of trust in employees that is reflected by the application of tight controls, sharp instructions and detailed budgets. Such an approach towards managing employees is in alignment with D. McGregor's Theory X. According to BBRT, companies need to make their new control system "transparent" and apply self-regulating mechanisms including key performance indicators  |
| Cost management               | There is a widespread view that costs can only be managed through detailed budgets and stringent controls. However, according to BBRT, traditional budgets are no longer the most effective way of securing an efficient use of resources. This is because the initial budget assumptions change given the turbulent and dynamic business environment. Thus, managers proceed in accordance with outdated plans and miss opportunities due to the rigid allocation of resources for a year ahead. Moreover, remaining resources at the year's end are often spent without any business justification so as not to lose them and be given less resources for the next year |
| Target setting and evaluation | Setting predefined absolute numbers as budget targets is often a narrow and misleading way of describing performance. According to BBRT, measuring and driving performance should be based on benchmarking techniques that allow focusing on outperforming competition rather than meeting agreed-upon absolute numbers. The benchmarking techniques are also perceived as a foundation of a self-regulating system utilizing positive peer pressure to drive performance among managers  |
| Bonus                         | Individual bonuses are external and imposed motivating factors. As far as the traditional budgeting is concerned, they are strictly tied to delivery of budget numbers. This stimulates negotiations at budget's preparation phase (managers negotiate the lowest possible targets and the highest bonuses) as well as the dysfunctional behavior later on  |
| Rhythm                        | Traditional budgeting sticks to a rhythm adopted from a fiscal year. However, it is not always aligned with business cycles. Due to the dynamic and unpredictable business environment, it is difficult to identify all the activities and resource needs for a year ahead. Therefore, initial budget assumptions change over time and ruin carefully designed plans entailing corrective actions   |
| Quality                       | Combining three different purposes, such as targets, forecasts and resource allocation, in a single budget often hurts their quality and causes dysfunctional behavior among managers who want to shape the purposes in their favor   |
| Efficiency                    | Traditional budgeting is a costly and lengthy process. This is partly because of the traditional management myth that the more detailed budgets are, the more control of the future managers have. The traditional budgeting involves many non-value adding activities  |

Source: author's own work on the basis of Bogsnes [2009, pp. 8–52].

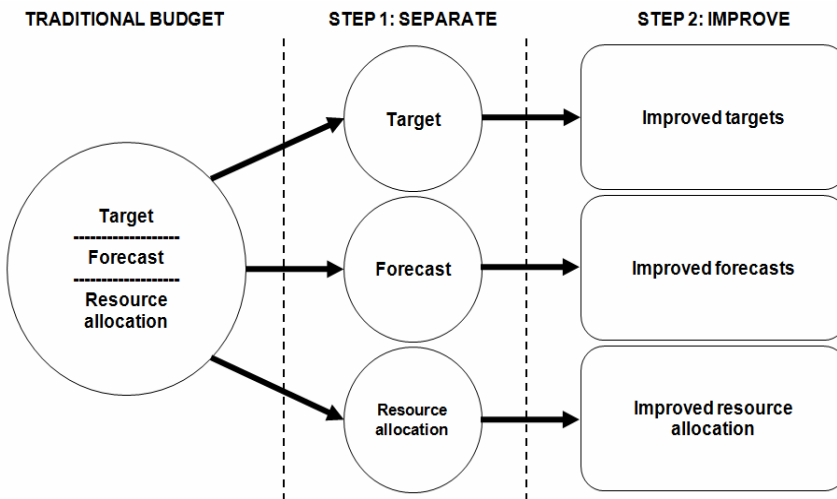


The multifaceted criticism of traditional budgeting is strictly connected with the changing business environment. According to BBRT, in order to be able to meet the success factors of information economy, traditionally managed organizations need to become adaptive and decentralized. Traditional budgeting remains a barrier to sustainable growth and needs to be abandoned and replaced with more efficient management practices.

### 3. Abandoning traditional budgeting

A traditional budget is an outcome of negotiations between a corporate center and business units. The final budget construction emerges as a compromise reached by all the interest groups involved in the process. Therefore, budget purposes such as targets, forecasts and resource allocation that are combined together may not be optimal from company’s perspective. When a reliable sales forecast is about to become a sales target, it is quite predictable that managers (during budget preparation phase) will try to bring it down as much as possible in order to be able to easily meet or exceed the target in the future and get the highest rewards. The same behavioral pattern can also be observed with regard to resource allocation (managers are willing to ask for more resources that they actually need) and it is called “a budget gaming phenomenon”. According to BBRT, it is an outcome of traditional budgeting’s systemic weaknesses.

There is no one way of abandoning traditional budgeting practices, but usually the first step is to separate the three budget purposes (target setting, forecasts and resource allocation) and improve their quality later on (see Figure 2).



**Figure 2.** Separating budget purposes  
 Source: author’s own study on the basis of Bogsnes [2009, p. 121].

An effective way of separating target setting and forecasting is to separate them in time [Bogsnes 2009, p. 120], which contributes to minimizing the budget gaming effect. The improvement phase is about making targets ambitious and relative to external and internal benchmarks. As far as forecasts' improvement is concerned, forecasts should be action-based, both financial and non-financial, and should provide a reasonable number of details. Resource allocation (the third budget purpose) should become a continuous, dynamic and self-regulating process. The improvement of the process is connected with avoiding resources' pre-allocation and creating an effective framework consisting of decision gates, criteria and key performance indicators for a stream of incoming projects.

Apart from separating and improving the three budget purposes, there is also a necessity to abandon the so-called fixed performance contract. J. Hope and R. Fraser define it as an outcome of a process of agreeing upon targets, incentives, plans, resources, cross-company commitments and performance measures between a superior and subordinate for a specified period [Hope, Fraser 2003, p. 213]. Such contracts may lead to dysfunctional outcomes especially if the pressure to improve performance rises and economic conditions deteriorate [Hope, Fraser 2003, p. 11]. Breaking free from traditional budgeting requires replacing the fixed performance contract with the relative improvement contract that fits the new management model based on the Beyond Budgeting concept. It is fundamentally different because a subordinate makes an agreement with their superiors that they are to use their best endeavors to continuously improve performance against specified benchmarks, peers, competitors or prior years. Their performance is evaluated with the benefit of hindsight [Hope, Fraser 2003, p. 215].

Abandoning traditional budgeting is a challenge connected not only with separating and improving budget purposes along with replacing the fix performance contract with the relative improvement contract. It is also connected with changing centralized mindsets and adopting a new management style. However, according to BBRT, all these steps are necessary in order to build an adaptive and decentralized organization that will be able to successfully compete given the dynamic business environment of the twenty first century.

#### **4. The Beyond Budgeting concept**

The Beyond Budgeting's framework consists of the principles of adaptive processes and the principles of radical decentralization. Along with company's values, they form a coherent management model supported by a set of tools including shareholder value models, benchmarking models, balanced scorecards, activity-based management practices, customer relationship management models, information systems and rolling forecasts. Their purpose is to enable companies to meet the success factors of the information economy. The principles of adaptive processes include:

- target setting,
- motivation and rewards,
- strategy process,
- resource management,
- coordination,
- measurement and control.

Target setting is about setting stretch goals aimed at relative improvement. This means that they should be based on managers' highest aspirations and not on the imposed corporate center's expectations. As far as the target setting principle is concerned, targets should be also set relative to external benchmarks and internal peers. The idea behind this assumption is that agreed upon benchmarks allow minimizing a need for negotiations. Managers' performance is evaluated based on the progress made against the benchmarks. Thus, a budget preparation process is shortened and simplified and managers need to set their goals high enough in order to perform well against their competition.

The principle regarding motivation and rewards is also based on the idea of relative performance which is holistically evaluated against a range of different factors. This means that managers' performance is compared with their external and internal competition as well as with their performance from past years. Unforeseen changes that occur on the market are also taken into consideration. Rewards can be based on multilevel performance (resulting from managers' individual appraisals and the performance of their business units) and on the relative success of the whole company.

As far as the strategy process is concerned, it is important to make it continuous and break it free from the calendar or fiscal year's timeframe. This is because strategic initiatives and economic or business cycles very often go beyond the one-year budget period. Apart from that, a strategy should be devolved to business unit teams to the extent depending on a number of factors, such as the culture of a business and the capabilities of front-line managers. Being involved in the development of a strategy allows front-line managers to make decisions that are aligned with it.

The principle connected with resource management is about making resources available as required. In order to make it an efficient process, there have to be sets of key performance indicators' parameters within which front-line managers could operate. Along with fast-track approval mechanisms for major projects, the principle forms a foundation for a self-regulatory system. Within this system, resources are allocated based on the real needs of front-line managers who have wide discretion over how they utilize them but are also bound not to exceed agreed-upon KPIs.

In the absence of budgets (that combine targets, forecasts and resource allocation for a year ahead), the coordination of projects and initiatives is real time. The advantage of such a solution is that cross-company actions are coordinated according to the prevailing customer demand. Therefore, the scenarios that will generate the highest shareholder value are given the highest priority over the other.

The measurement and control principle is about basing controls on the effective governance and on a range of relative performance indicators. It is connected with setting boundaries and guidelines for strategy development and decision-making. In order to increase the effectiveness of such a multilevel control system, it is highly advisable to produce fast financial actuals, use trend analysis as well as rolling forecasts and performance rankings.

The Beyond Budgeting's framework also consists of the principles of radical decentralization. They aim at effective empowerment of front-line managers so that they are able to make independent and value creating decisions that are aligned with their company's strategy. The principles of radical decentralization include:

- governance framework,
- high performance climate,
- freedom to decide,
- team-based responsibility,
- customer accountability,
- open and ethical information culture.

Contrary to the traditionally managed companies where guidelines are made of mission statements, plans and budgets, in the empowered companies there are clear principles, values and boundaries within which employees operate. Such a framework allows front-line managers to make local decisions and holds them accountable for their outcomes. As far as hierarchical dependencies between superiors and subordinates are concerned, in the empowered organizations there are coaches and mentors rather than commanders and controllers. Therefore, superiors advise and share their knowledge rather than give commands and detailed instructions. They intervene only if boundaries are breached.

Creating high performance climate based on relative success is another principle of radical decentralization. In order to put this principle into practice, leaders need to focus on three crucial activities, such as championing relative performance (by setting external and internal benchmarks), challenging ambition and balancing competition and cooperation within their company.

Giving employees freedom to make local decisions (that need to be consistent with governance principles and company's strategy) is connected with instilling a culture of responsibility instead of dependency. In order to achieve this, leaders need to involve front-line employees in strategy formulation process so that they are able to understand and develop companies' objectives. In the absence of budgets, front-line employees are forced to think more deeply about a business (especially about constraints, commitments, innovation, investments, competencies and risks) so that they are aware of potential consequences of their decisions.

Devolving authority and responsibility to front-line teams as well as making them accountable for customer outcomes are other steps towards making a company adaptive and decentralized. The idea behind these principles is to create a network of

small and customer-oriented teams that are capable of making independent decisions that are in alignment with an overall strategy. The performance of such teams can be easily compared and evaluated. Therefore, front-line managers' ambition is stimulated and peer pressure plays a major role in driving continuous improvement. However, such an approach towards running a business requires recruiting people who prefer open management style rather than strict hierarchical dependencies.

Supporting open and ethical information culture is another challenge for companies that strive to become adaptive and decentralized. The main assumption is that relevant information should be delivered to the right people at the right time. Therefore, the decisions made by front-line managers can be fast and well-informed. Another assumption is to set high ethical standards for information flow, which means making information transparent and accessible. Thus, it is not limited and it is not used for individual purposes.

As far as tools and systems are concerned, according to BBRT, abandoning traditional budgeting unlocks the potential of shareholder value models, benchmarking models, balanced scorecards, activity-based management practices, customer relationship management models, information systems and rolling forecasts. They form a coherent set of tools that fits into the Beyond Budgeting concept. They are aimed at supporting front-line managers in a decision-making process. Shareholder value models provide them with information for value-based decisions, whereas the benchmarking models provide information on competitive rankings. Thanks to the balanced scorecards, front-line managers are provided with information regarding leading KPIs and a strategic framework for their decisions. Information on customers' profitability and capacity constraints is derived from the activity-based management practices and the customer relationship management models. Enterprise information systems provide fast actuals, rolling forecasts and market intelligence.

According to BBRT, the Beyond Budgeting concept is in tune with the success factors of the information economy (such as innovative strategies, low costs, loyal and profitable customers and ethical reporting). The application of the principles of adaptive processes and radical decentralization contributes to releasing full potential of processes and tools as well as providing high performance capabilities. Therefore, companies are able to sustain competitive success.

## **5. Concluding remarks**

The traditional budgeting is a coherent system deeply rooted in a traditional management model. However, it is not just a logical system. It coexists with a cultural system: a set of budgeting behaviors. The budgeting culture defines what success looks like (hitting targets), good practice (everything being reconciled) and legitimizes the budget gaming behavior [Morlidge 2010, p. 235].

Therefore, the criticism from BBRT aimed at traditional budgeting is multifaceted and leads to the conclusion that traditional budgeting is outdated and fundamentally flawed and cannot be improved without undertaking radical measures. As a consequence, in order to sustain competitive success in dynamic and turbulent information economy, companies need to abandon it and become adaptive and decentralized according to the Beyond Budgeting's philosophy.

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## Website

[www.bbrrt.org](http://www.bbrrt.org)

## KONCEPCJA BEYOND BUDGETING I WIELOPŁASZCZYNOWA KRYTYKA TRADYCYJNEGO BUDŻETOWANIA

**Streszczenie:** Głównym celem tego artykułu jest przedstawienie zarysu koncepcji *beyond budgeting* oraz wielopłaszczyznowej krytyki tradycyjnego budżetowania. Zgodnie ze stanowiskiem *Beyond Budgeting Round Table* (wielobranżowego programu badawczego) zmieniające się środowisko biznesowe zmusza przedsiębiorstwa do zakwestionowania efektywności narzędzi i technik zarządzania takich jak tradycyjne budżetowanie. Postrzeganie tradycyjnego budżetowania jako kosztownego i fundamentalnie wadliwego systemu przyczyniło się do powstania koncepcji *beyond budgeting*. Jest ona oparta na dwunastu zasadach (które obejmują procesy adaptacyjne oraz radykalną decentralizację), wykorzystując zdolność innowacyjnych narzędzi zarządzania do kreowania wartości dla akcjonariuszy.

**Słowa kluczowe:** koncepcja *beyond budgeting*, program badawczy *Beyond Budgeting Round Table*, budżetowanie.