Bulletin of the *Transilvania* University of Braşov
Series V: Economic Sciences • Vol. 8 (57) No. 1 - 2015

The pros and cons of budgeting system within economic entities

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Abstract: *The budget is a key instrument of management control. Today it is found that all businesses or organizations, except perhaps some craft enterprises, establish a budget. The purpose of this research is to find solutions for increasing the efficiency of budgetary system within economic entities. The first part of the article highlights the advantages of implementing budgets and budgetary control in enterprises. The analysis continues to highlight their criticism. The last part of the article proposes measures and actions that should be taken to limit the negative aspects and to achieve an efficient budget system, so that the budget to be conceived as a management tool, integrating into a broader overview performance assessment.*

Key-words: *budget, responsibility, forecasts, budget control.*

1. Introduction

To manage a business, an enterprise, means to plan, organize, command, coordinate, control. Planning is the first function of management and it is the process by which the company objectives are set and also the means (resources, actions) by which the objectives will be achieved. Forecasting is the essence of management and it includes both assessment of the future and making predictions on it (Simionescu et al, 2006, 120).

Some managers consider planning as the basic function of management because by all managerial actions of organization, management and control, it is seeking the enforcement of planning decisions. Budgeting is the last stage of the planning process, following the operational planning, and it consists of detailing the business objectives for the first year of the operational plan. Through the budget, there are determined the work programs for a period of one year and there are allocated the necessary resources for carrying out the programs.

Sometimes praised, sometimes criticized, the budget remains a major tool of management control. The pros and cons are highlighted below.

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2. Pleading for the budgeting syste

Over time, many authors have tried to define the budget. Anthony defined it as “a plan for the following year usually expressed in monetary terms” (Anthony, 1988, 17). The word “budget” is a generic term covering short-term plans of any kind. The budget, by its monetary dimension is the most practical way to express the size of the inputs and outputs predicted (Anthony 1988, 94). It facilitates the convergence of goals, improves the effectiveness and efficiency of the organization (Anthony, 1965, 45).

Budgets are, by definition, forecasting situations (Dupuy & Rolland, 1991, 35). Budgets coordinate actions within the enterprise, through them is performed the forecasting management allowing the company to prepare for the near future.

A budget can be considered as a coherent set of assumptions and forecast figures fixed before the beginning of the accounting year, describing the company’s overall business. The most important data are the objectives to be achieved, which should be ambitious but realistic, defined as a result of a dialogue between the responsible persons, regardless of their hierarchical level. Budget allows clarifying responsibilities, performance, means and action plans consistent with the actions of different actors within the company in decentralization (Selmer 2009, 2).

A budget is valuing a work program resulting from an action plan adopted by the company. Through it, there are structured missions to be accomplished in order to improve the performance of companies, intervening to regulate any malfunction. The budget shows how profit will be obtained. It allows the identification of its generating factors so that responsible can act on controllable elements that influence the achievement of this priority objective (Aslău 2001, 133).

The budget is both a prediction tool, that enables the implementation of a proactive development policy (annual declination of strategic plans), but also a vertical coordination tool (between management and those responsible for various services) and horizontal (between different services or functions), it concerns and harmonize the requirements and constraints of each, from purchase to sale.

The budget is a privileged instrument of management control (Albu & Albu 2003, 18). The budget is both a management tool for the budgeting control and also a means of organizing the responsibilities and transmitting orders – or objectives – the latter term being considered more motivating (Burlaud & Simon 2003).

Alain Burlaud and Claude Simon define budget as “a set of digital, realistic and voluntary predictions” (Burlaud & Simon 2003). It is a set of predictions whose horizon is generally annually. The figures are both composed of physical data (quantities produced and sold, number of staff etc.) and value. It must be realistic, meaning to consider external (competitors, market development etc.) and internal constraints (production capacity, financial constraints etc.). But the budget is not just an anticipation of the future, it is more a voluntary action plan that reflects business objectives.

The budget provides, in financial expression, sizing the objectives, costs, revenues and results in the management centres and finally, evaluating economic efficiency by comparing the results with their budgeted level (Verboncu & Nicolescu 1999, 357).

The budget is also defined as "a stable plan for a certain period, expressed in financial terms and that specifies the resources allocated to achieve the objective of that period, and also the responsibilities entailed for achieving that objective" (Russu 1993, 328).

Anthony (1988, 94) summarizes the aims of the budget and budget preparation process:

1. motivating managers;
2. informing managers about what is expected of them;
3. obtaining a commitment of managers;
4. coordinating the various activities of an organization;
5. providing standards for judging the actual performance.

For a better pursuit of the objectives set, the annual budget can be divided into budgets for short terms, such as quarters, months, weeks and even days. The budgeting process should be seen as a step to achieve the long-term plan. The budget plays an essential role of coordination and communication within the company and serves as an instrument of delegation and motivation.

The existence of a single budget across the entire enterprise and the analysis of the results made on the basis of this general budget do not make it possible for decision-making organs to know which are the businesses operating efficiently and which are the deficient ones that reduce the enterprise results. The implementation of a budget system requires primarily the development, within the company, of a management structure based on responsibility centres to deal with the optimization of using resources and making profit. Each centre will have its own budget, thus being able to know who is responsible for any negative results. So, each decentralized entity must be equipped with budgetary targets on prediction, which will guide management leadership throughout the period covered by the budget. The minimal coordination between functions such as policy production articulation based on storage policies and objectives of sale is made while constructing the budget. The budget is a calculated short-term plan, allowing the allocation of resources and responsibilities. Thus, the budget is part of the tasks of all responsible engaged in managerial activities, in relation to the delegation entrusted.

The budget indicates the parameters to be achieved (the sales and production, the costs to achieve them), thus representing a framework for judging and analyzing performance. The budget commits managers of responsibility centres to foresee the consequences of decisions they make. The budget shows the ways to be followed for achieving goals set for the next financial year. For the next year's budget to be reliable, it is necessary to know the exact characteristics of the current period and the conditions under which the current activity operates.

A tool of management control, the budgeting system, with all its components, is not for external users, but it serves the domestic needs of the enterprise. The budget does not fulfil its role, however, without going through the stage of controlling the achievements to forecasts. In addition to forecasting, which represents an undeniable advantage of the budget, using budgeting in the enterprise management has many benefits, including: communication, coordination, authority, responsibility, mobilization, motivation, support in decision making.

The budget remains a management tool par excellence. Today it is found that all businesses or organizations, perhaps except the craft enterprises, set a budget. Optimization of budget preparation and planning practices brings management (Selmer 2009, 2-3):

- enhanced efficacy in its daily mission;
- better defining and implementing the strategy;
- increased relevance of forecasts.

The budget enables the company to improve communication with investors, to strengthen its credibility and thus to obtain confidence on the market. An effective budget–plan process improves stock performance.

3. Critical analysis of the budgeting system

By decentralizing the objectives and the control over their implementation, the budgeting management appears as an effective system, which is why almost all large organizations have appealed to it. However it has certain limitations that should be mentioned.

The first criticism of the budget was formulated in 1930 in a study of the “National Industrial Conference Board” which indicated that budgets imposed may do more harm than good and may cause dissatisfaction among managers. Budgeting systems are sometimes mistakenly addressed, without taking into account the increasing role of the human factor. This aspect can cause antagonism and determines performers’ low morale and motivation.

Argyris (1952, 3) points out that this instrument is in the centre of behavioural problems of individuals. He makes severe criticism against it and reveals its negative effects: managers’ stress, short-term orientation, cooperation obstacles etc. Participation to the budgeting process could remedy some frustrations regarding budgets.

Jensen (2001, 95) points out that the budget is a joke. Budgeting takes time from managers, forcing them to take repeated and lengthy meetings, and engage in tense negotiations. He encourages managers to lie and to cheat, to minimize objectives and to inflate results and sanction when telling the truth. It turns decisions into a game and provokes colleagues against each other, leading to mistrust and resentment. It produces distortions in providing incentives, motivating people to act in a way that is against the interest of the company.

Alain Burlaud and Claude Simon mention that one of the criticism is based on the fact that budgeting involves cutting an enterprise into centres of responsibility (profit centres, cost centres, turnover centres etc.) to which objectives are assigned and those responsible are judged depending on their achievement, on the compliance with the budget. In this context, everyone defends their own objectives, even if this is done at the expense of other centres in the same undertaking. Qualitative aspects, in general insufficiently considered in budgetary techniques, such as periods or quality, tend to be managed by each depending only on their own incidence within results. In other words, budget management responds to the postulate – questionable – that the public interest is reducible to the sum of particular interests. Many times it denies solidarity, interferences or transversality and strengthens selfish behaviour. Internal transfer prices often reflect the most acute problems, the difficulties of their fixing show the fragility of the balance between responsibility and cohesion (Burlaud & Simon 2003).

Another criticism results from the fact that complying with the budget often becomes an end in itself. In activities of structure or support in which spending is essentially discretionary and the activity is difficult to assess, responsible, considering their own interests in entities concerned, tend, on the one hand, to try to obtain a maximum budget amount and on the other hand, fully consume this amount. Activity management strives to provide some solutions to this type of malfunction.

Budget controlling is also blamed for the fact that deviations from budgeted values sometimes occur due to changes in real conditions of activity compared to the ones considered when developing budgets, due to poor forecasts or poor management performance. Among the causes that give rise to such deviations we can indicate changes in prices of raw material supply over which enterprises have no authority to act and that lead to production costs different from those of the budget.

In operational activities, the budgeting management often has a tendency to break initiatives and innovations and this is because any change leads to deviations which must be further analyzed, explained and justified; thus, it generates an extra cost often considered as prohibitive.

Another criticism stems from the fact that the budgeting cycle which is usually annual, with monthly or quarterly control of the way of making predictions is often bad adapted to the economic cycles of businesses. The budget tends to shorten the horizon of management and to generate behaviours that favour short-term at the expense of the long-term. Implementation of quality procedures is often a favourable response to this type of dysfunction difficult to detect and correct (Burlaud & Simon 2003).

Lack of long-term vision and strategic perspective is undoubtedly one of the major limitations of traditional budgets. Often, the budget is not in line with the strategic plan of the company. The existence of long-term plans sometimes causes company's stiffening, not allowing it to adapt to opportunities that arise during the year. The existence of well-documented programs may lead to inertia and lack of flexibility in adapting to changes. Developing budgets shall be done in accordance with existing structures of the company (with current organizational chart) that may be inappropriate for the current situation. Also often budgets are an extrapolation of the past, they integrate few elements of change or reflection.

Everyone recognizes the effectiveness of traditional budgeting (incremental budgeting) as long as it is about direct production expenses. This is not the case for overheads and indirect expenses much more since it appears that the share of overheads and indirect costs in the full cost becomes higher. For these expenses, budgets obtained by this method serve as a basis for analyzing deviations, but this analysis can never have the same relevance as it does for operational services, for many reasons:

- it is always difficult to assess the real usefulness of the work done and if the benefits from the activity of such services justify their costs;
- it is difficult to find criteria for measuring the performance of such services. Generally it is impossible to determine standards and to identify units of work and sometimes it is not even possible to make predictions because activities are not always repetitive;
- the relationship between effort and performance is never very clear;
- to limit the risk of reducing budgetary allocations, heads of functional services are tempted to note in their draft budget at least the same amount that they obtained in the previous year, although funding needs are less compelling;
- they are also tempted to "swell" currency to protect themselves against possible risks. Subsequently amounts thus allocated are a great temptation to be spent.

This budgeting reduces the flexibility of the organization, which is not ready to cope with change. Incremental budget is criticized because it is inconsistent with the principle of budget planning, which involves anticipating future goals. It identifies short-term variable costs, but it does not accurately identify costs with logistics and distribution, marketing and sales, design and development. These non-production costs are treated as fixed or recurring charges (Caraiani 2004).

Incremental budget shows the nature and not the purpose of spending, it does not refer to the level or scope of activities. Another weakness of this budgeting technique is that it does not address the concepts of efficiency, effectiveness. Incremental budgets are prepared for the use of production capacity expected in the year of budget which often is less than 100%. Incremental budgeting is a simple method, easy to perform, which saves time, but it is also a "lazy" method and often less accurate. It is a method that works well on short-term and where there is great complexity of activities. This budgeting technique is good for stable organizations, where radical changes do not occur from one year to another.

The budget is perceived as an artificial instrument developed for use by financial officers and management controllers, leading to unjustified provisioning and shift spending from year to year. The budget seems like a less operational tool and poor decision-making aid. It is estimated that preparing the budget requires spending too much time and consumes too much energy at the expense of other activities related to their profession. Negotiating objectives has no consequence, discussions are extended too far, decisions are deferred and budget does many shuttles between the general direction, management controller and competent services (Selmer 2009, 218).

Some budget roles are incompatible and its use for different roles may lead to contradictory effects. There are two major conflicts:

- budgets used for planning should be set at a realistic level to allow the allocation and coordination as if they are used to motivate, they must be fixed so as to be more challenging. There is thus a contradiction between the desire to objectively foresee the future and the desire to determine managers to commit to ambitious goals. Objectives are false, management no longer has a forecasting tool nor a system of mobilization (Bouquin 2000b, 55-66).

- budgets used to motivate must be fixed in general. On the contrary, the most effective budget for evaluation should be designed and implemented so as to consider the impact of uncontrollable or unpredictable events (Barrett & Fraser 1977, 115). Barrett and Fraser hypothesize that an effective budget is an accurate budget, meaning it takes into account the factors on which the responsible cannot act. They assume that organizational justice favours performance. By using this type of budget might still reduce the motivation of managers if they know a priori that they will be held responsible for uncontrollable things.

Finally, superiors' and subordinates' interests vary according to the role that is given to the budget. Thus, if the budget is primarily used for a purpose of planning, the controlled people have an interest in obtaining higher budgetary targets to have extra resources. If the budget is used for the purpose of motivation, the controlled people will seek to minimize their goals for increasing opportunities to achieve them (Barrett & Fraser 1977). To reduce conflicts due to budget functions, Barrett et Fraser proposed to introduce sliding budgets.

4. Solutions for an effective budgeting system

In order to limit the negative aspects and to achieve the success of budgeting and budgetary control some requirements are required and they are highlighted below.

It is important, first of all, to have a clear definition of objectives and responsibilities, by establishing clear guidelines so that every employee knows what to do. The requirements are the following: the involvement and support of top management in budgeting, a realistic organizational structure, with the involvement of responsibility centres managers in all aspects of budgeting.

A budget leading to growing the company's performance is the budget that reveals the origin of figures, by giving up incremental budgets, completing financial data with operational elements and integration, during the preparation of budgets, of complementary analyzes. An important role in making budgetary control is assigned to an adequate accounting and information system allowing accurate and timely reporting of achievements in comparison with forecasts and correlation of expenditure and revenue records with responsibility (Simionescu et al 2006, 407).

Budgeting period should not be seen as a time to do calculations, but as a time when decisions are made. The complex calculations overload should be avoided at all costs, (Selmer, 2009, 218), by limiting steps of budgeting and establishing precise procedures of budget drafting, procedure to be known to all participants at the budgeting process.

For budgetary system to increase the company's performance, it appears necessary to build a system of interactive planning and using long-term budget for articulating long-term with the short term. Managing budgets in a flexble manner is also important, allowing budgets reviewing when necessary. An incremental budgeting improvement is brought by flexible budget. Prepared for further utilization of production capacity, the budget takes into account possible fluctuations in the period for which the budget is drawn up, it adapts to predictable changes that may occur in the volume of activity of the undertaking. It becomes an important tool of management, both in terms of control and analysis of the conduct of business and in terms of knowing the causes of deviations (Epuran et al 1999, 287).

The proposal of several budgeting versions becomes necessary, in order to meet the diverse requirements of management and ownership and disposition of forecasting tools allowing the simulation of these different assumptions. Integrating budgeting and budgetary control within a data processing system to enable speed and flexibility becomes imperative for an effective budget.

Gervais (1994, 24-25) mentions that the actions taken by the company's management, aiming to increase the motivation of employees, must take into account some rules. Rewarding success (premiums, promotions etc.) should take place when it (success) occurs; thus strengthening the staff commitment to the company.

Generous rewards made constantly lose their impact because the staff expects to receive them. Unpredictable and intermittent rewards are those that work better. Also, small rewards are more effective than larger ones. Large rewards have as negative effects intrigues and a struggle to get them. They discourage those who never get them, though they think they deserve them.

A better response from employees is obtained by using several different kinds of incentives, of financial and non-financial nature, rather than by using the same kind. It is preferable to choose incentives to act on a still unmet need than on needs partially met. Too harsh assessments should be avoided because when a person receives a "looser" label, he or she tends to behave as such. It is essential that this person clearly perceive that, for a given performance, he or she has the chance to get the reward provided. The time that elapses between finding performance and receiving reward should not be too long.

Everyone needs to give meaning to his life and for this they are ready to make many sacrifices if the organization where they work asks for this. When a company's management is careful with the wishes and concerns of people, leaving them a minimum of initiative and control over their work, their adhesion to the company is reinforced.

5. Conclusions

After analyzing the pros and cons of the budgeting system, I believe that the budget remains an essential component of the functioning of the company, with which it is possible to ensure the consistency of local actions with overall performance of the company. The budget is a tool to support the decision. Often, before establishing the final budget, managers measure the impact a decision can have on the forecast outcome.

I believe that the benefits obtained by using budgets exceed almost always the costs of organizing the budgetary system and that budgeting management, with all the criticism, should not be rejected, but should be conceived as a management tool, integrated in a broader performance assessment, more diverse and often more qualitative.

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