PURPOSE FOR BUDGETING – LITERATURE REVIEW

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Abstract
This paper studies the literature regarding budgets and their importance within a company. In the current economic climate, companies are starting to pay more attention to efficient management of resources and, for this purpose, use budgets as tools for financial management at company’s level and at the level of the main types of company’s activities. So, the budget is the most important tool in conducting any activity successfully. A budget is the tool by which a company’s management translates into action the corporate strategies and quantitative mission statements.

Keywords: budgets, budgeting, performance.

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1. INTRODUCTION

The existence, development and environmental adaptation of an economic entity generate a complex network of financial flows that define the general assembly of financial economics at both microeconomic and macroeconomic level, nationally and internationally. Developing a company must be based on knowledge of its capabilities, weaknesses and strengths as well as external macroeconomic environment. From these results it is absolutely necessary to develop an appropriate policy to ensure not only the maintenance of the business to a certain level but also for development in accordance with the changing economic environment in which it exists and operates.

For this policy to be as accurate and useful to executive bodies of the economic entity it must set clear financial goals to be achieved and to accurately scale capital needs that can be used cost-effectively. Also, such a policy must be geared towards the future and try to predict optimal financing possibilities depending on existing costs on raw materials, capital and finished goods markets in which the company operates.

To ensure a dynamic balance on both short and long term, the company’s management is obliged to pay attention to how they are planned and carried out all financial processes within the company:
- capital needs assessment;
- finding funding opportunities;
- organization of raised capital using in the most efficient manner possible.

In the context of a competitive market economy, business activity should be conducted profitably according to a balanced relationship between revenues and expenditures.

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To conduct a profitable business the management of any economic entity has to predict expenses, receipts and payments for a certain period of time. This is why budgets have grown to be a primary tool for financial forecasting within economic entities.

In the current economic climate, companies are starting to pay more attention to efficient management of resources and use, for this purpose, budgets as tools for financial management at company’s level and at the level of the main types of company’s activities. So, the budget is the most important tool in conducting any activity successfully.

2. DEFINING BUDGETS

“Rigorous planning …of any economic activity is an essential element for the success of those activities. Without planning the activity of any economic entity would detach from surrounding reality …the capacity for provision and planning of any activities in a market economy conditions assures the survival and development of these activities” (Achim, 2009, p.33).

In general the term budget is seen as representing a list (a document) in which are placed face to face predictable revenues and expenditures of a particular economic entity, for a specified period. This approach corresponds to reality, but at a more detailed analysis, this expression reflects a methodological category specific to finance, seen as a scientific discipline. Under this, budget can be interpreted as a general finance specific methodological process through which, it highlights how formation and sizing of financial resources it is done in particular economic entities, on the one hand, and the distribution to various destinations of resources for the fulfillment of predetermined targets, on the other hand.

The budget is a planning document which contains a number of financial and / or nonfinancial information that refers to the activities that will take place in the future. Budgeting is the activity of recording financial and / or non-financial elements into the budget (Achim, 2009a). Blumentritt defines budgeting as “the process of allocating an organization's financial resources to its units, activities and investments” (Blumentritt, 2006), while Horngren et al. sees budget as the quantitative expression of a proposed plan of action by management for a specified period and an aid to coordinating what needs to be done to implement that plan (Horngren et al., 2004).

The income budget represents the financial estimation for sales of company’s products and services and the expenditure budget is the financial estimation of resource consumption necessary to achieve company’s objectives. So, the budget is a financial or quantitative statement, containing the plans and policies to be pursued during a specific time period (typically a year).

All decisions made at the company’s level (technical, economic, organizational and others) result in affecting the existing financial balance and determine the need for a new balance, employing for this purpose changes in the level and structure of funds and resources needed to finance them. The new financial balance requires reliance on a higher level of financial indicators by budgeting. The income and expenditure budget is therefore the company's financial program with which it predicts revenues, expenditures and financial results of its activities, own funds and the loan, businesses relationships, payments to the budget and others.

Planning finances of a company is achieved through the process of budgeting the business activity. This is an operational plan on a given time horizon, usually one year, which includes forecasting revenues and expenditures of a company, additional capital needs and how to finance them and the main indicators characterizing the hoped efficiency. Even if the budget is a financial plan regarding future revenues and costs of a business, it is about much more than just financial numbers. Budgeting process involves choosing specific
objectives of future activities and company policies, programs and procedures designed to ensure the necessary conditions for achieving these objectives.

The purpose of the budgeting process is to ensure that the financial resources available for a company are used efficiently, for both new attracted resources to finance its activities and excess of capital flows from previous business activities. "At the annual financial budgeting stands a strategy for business development in a predictable timeframe for achieving an acceptable probability. Spearheading of this strategy is the marketing studies that may reveal possible future market size and the market slice that the company could count on" (Giurgiu, 2000).

3. BUDGETS’ PURPOSES

Budgets have always played a key role in managing an institution, both private and public, being an important control system in many companies (Ekholm and Wallin, 2000, Merchant and Van der Stede, 2003). Otley sees the budget as the central stage of most organizations’ systems of management control (Otley,1978). The overall objective of the budget is to keep control of the activity done in the company by providing a roadmap for future activities and to set a series of goals to be achieved and the means by which to achieve those goals (Achim, 2009a). Therefore the management efficiency can be appreciated by the achievement of predefined objectives and the means used to their achievement. There are several empirical studies that demonstrate that budgets are one of the most used planning and control tool for companies (Abdel-Kader and Luther, 2006, Uyar,2009).

Managers are responsible for the realization of the indicators within their budgets and for any variance from the estimated values, cases in which they are required to take remedial action. Budgets are used by management for different uses (Riley, 2012):

- control income and expenditure (the traditional use);
- establish priorities and set targets in numerical terms;
- provide direction and co-ordination, so that business objectives can be turned into practical reality;
- assign responsibilities to budget holders (managers) and allocate resources;
- communicate targets from management to employees;
- motivate staff;
- improve efficiency;
- monitor performance.

According to Romanian authors (Achim, 2009a) budgeting purposes (budget functions) are the following:

1. Planning operations that ensure the companies’ strategic objectives realization.

Budgeting process stimulates managers to predict all the problems before their appearance and thereby avoid making hasty decisions in the event of certain undesirable situations in the future. We can say that budgeting "guarantees" that they will plan future operations depending on how it was accomplished the previous budget, taking into account all the factors that have influenced changes regarding previous budget indicators.

2. Coordinating various activities of different types of subdivisions. Coordination of each employee and groups interests.

Each subdivision of an economic entity has its own objectives and this can lead to situations in which these goals are contradictory in relation to other responsibility centers. So, the budget has the role to reconcile and regulate these contradictions in favor of the economic entity so that these situations can be prevented.

3. Stimulation of managers from all business levels to achieve predetermined goals of each responsibility center.
This budget feature strongly manifests in case of participative budgeting when responsibility center managers can propose various quantitative indicators. Therefore the budget indicators are indicators not forced to realize from the center but settled by mutual agreement with the management of each responsibility center.

4. Control of current activity, ensuring discipline according to the business plan.
   Careful drafting of budgets ensures the optimum standard to compare undertaken activity achievements, to determine deviations and to take measures to eliminate them.

5. Evaluation of plans fulfillment by each responsibility center and their managers.
   Management performance can be appreciated by comparing the results with those expected to be achieved.

6. Training managers and other employees from financial services of a company.
   Budgets are considered to be highly beneficial to companies (Wijewardena and Zoysa, 1999) The usage of budgets has a number of advantages (Epuran, 1999, Achim, 2009a):
   • requires the use of planning in business management;
   • represents the framework for assessing performance due to indicated parameters that the company needs to realize in order to achieve her objectives;
   • promotes communication and coordination for engagement and balancing all departments and functions of the company in order to achieve its set objectives;
   • undertakes responsibility center managers to foresee the consequences of decisions made or to be taken, budgets representing a landmark in decision making;
   • allows the existence of an efficient accounting information system that provides all kinds of information necessary for users (especially internal ones);
   • provides leadership through exception because if the budget is well-designed, management needs to intervene only in situations where there are deviations from budgeted indicators;
   • ensures participation in the planning activity of both management and performers that drives involvement in achieving or exceeding budgeted indicators.

There was conducted a lot of research regarding the role and the importance of budgets within a company. Different authors evidence the fact that budgets are the most used tool for planning and controlling within companies in both developed and developing countries (Dugdale and Lyne, Ahmad et al., 2003. Joshi et al., 2003, Wijewardena and Zoysa, 1999,Ghosh and Chan, 1997). In the studies conducted by Jones the results obtained showed that there are three major reasons for which companies use budgets: evaluate performance, aid control and planning (Joshi et al., 2003). Other authors evidence others benefits of budgeting such as preventing information asymmetry between top managers and lower-level managers, enhancing employees’ work attitudes, providing motivation to department and committee heads and resulting in a greater level of goal commitment by lower-level managers (Oak and Schmidgall, 2009, Joshi and Com, 1997). According to Turkish authors Ali Uyar and Necdet Bilgin, the reasons for budgeting, in the order of their importance are: control expenses, profitability, aid long-term planning, co-ordinate the operation, aid short-term planning, evaluate performance, motivate managers, motivate employees and communicate plans with employees (Uyar and Bilgin, 2011). There are numerous authors that consider budgets as intended strategy operationalization through resource allocation and assessment of strategy (Hansen and Van der Stede, Anthony and Govindarjan, 2003, Merchant and Van der Stede, 2003). Shields and Young consider that budgets contribute in creating a culture of democracy
within a company (Shields and Young, 1993) or at least an appearance of democracy that brings the legitimation of a company (Covaleski et al., 2003).

All the mentioned objectives and functions of budgets are achievable due to budgetary control. Budget execution control is the process of determining and analyzing the deviations of effective values of indicators from the predetermined values (Achim, 2009a). The most important advantages of budget execution control are (Achim, 2009a):

- it is useful to managers at different hierarchical levels because it is a daily guide for their activity;
- allows senior management to achieve a synthesis analysis of the business’ activity which allows it to objectively assess low-level managers work;
- allows the knowledge of the meaning and importance of deviations in comparison with forecasts, that leads to increased efficiency in key areas of economic management of the entity;
- enhances coordination of activities carried out in different functions of the company, allowing decentralization of responsibilities;
- leads to technical and economical updating where necessary.

But, we should also consider the criticism mentioned by different authors regarding the process of budgeting. The most mentioned “black ball” of the budgets is about the time consumed with this activity (Otley, 1978, Neely et al., 2003, Wu et al., 2007, Hope and Fraser, 2003b). Another criticism discussed is the fact that budgets can be affected by corporate politics and gaming (Otley, 1978). Some authors consider as a problem for budgeting the way budgets are used (Horngren at al., 2006) while others sustain the idea that budgeting processes are fundamentally flawed (Hope and Fraser, 2003a). To sustain all this, there are authors that named budgets as being an “unnecessary evil” (Wijewardena and Zoysa, 1999), “a thing of the past” (Gurton, 1999) or even “broken” (Jones, 2008). All the criticism brought to the use of budgets is called the “beyond budgeting” approach.

With all this criticism the majority of economic entities continue to use budgets in order to control the realization of establish objectives. This means that budgets, if they are used appropriately and adapted to a company’s needs can be a tool for obtaining value-added. The key for this is to implement practices that generate commitment to budgets, adopting clear procedures to prepare budgets, creating linkages to connect the budget with the company’s strategy and analyzing budget variances and taking corrective action (Uyar and Bilgin, 2011). To this we can add the clear definition of managerial responsibilities, drawing up a plan of action for each individual budget and continuous monitoring of performance.

The response to all criticism of budgets is found in the multiple roles of budgets that combined can enhance performance (Uyar and Bilgin, 2011).

There are different reasons for which companies use budgets. The key purposes of budgets can be translated into planning the use of resource, forecasting the future, assistance in performance evaluation and maximization, assuring the means of communication for the management, controlling the activities of various groups within the firm, motivating employees to achieve performance, controlling performance by investigating variances, resolving conflicts of interest between groups with the organization, pricing decisions and control (Riley, 2012, Oak and Schmidgall, 2009, Cruz, 2007, Ahmad and Suleiman, 2003, Joshi and Com, 1997, Joshi et al., 2003).

4. CONCLUSIONS

We consider that Pyhrr words reflect the importance of budgets for a company’s management. About budgets Pyhrr said that “with it, managers can reassess their operations
from the ground up and justify every dollar spent in terms of current corporate goals” (Schiels and Young, 1993).

The budgeting process has some features that are particularly important for any economic entity. First, it is oriented towards a specific well established purpose of the company that provides management a good reference for the assessment of predetermined objectives. Secondly, favors the introduction of a system of control over the management of all types of resources used within a company and thirdly, but not least, it coordinates the efforts of all organizational structures of the company in achieving the objectives set, as all are engaged and involved in the budgeting process.

This is why an efficient budgetary systems has a positive impact on the ability of the management to anticipate and respond with articulated measures to opportunities and pressures from the environment in which the company operates, this being a critical aspect for a company’ survival in a changing business environment such as the present one, due to the fact that budgets are an interactive tool between different levels of management, assuring an open dialogue within a company.

At the question “Why budgeting?” we surprised in the paper a lot of opinions consisting in lists of reasons for budgeting and we found hard to choose the best list, but we can choose from all the lists the most mentioned ones: organizational planning, performance evaluation, organizational control, communication of goals and strategy formation. Different contexts determine organizations to have different potential reasons for budgeting. The idea of multiple uses for budgets isn’t new in the specific literature, as we could see, but the continuous change in the business environment determines the change over time of the budget’s uses within a company.

5. REFERENCES