The Limitations of Traditional Management Accountancy Techniques: An Assessment of Budgets in Managerial Decision Making

This essay will focus on the challenges facing businesses when making and implementing decisions using management accountancy techniques and tools. Because of space limitations, only one tool is considered here, and that is a simple but important one: budgets. The budget is defined by Drury (2013) is a "financial plan for implementing the various decisions that management has made," expressed "in terms of cash inflows and outflows, and sales revenues and expenses" (p. 12). With the information produced from the budget, accountants could conduct product profitability analysis for short term decisions, while capital investment decisions may have been associated through the discounted cash flow information from the budget (Drury, 2012). Since the early twentieth century, budgets have traditionally been deployed to assist the organisation in making decisions, enacting strategic change and supporting the firm's objectives and goals. In fact, noting its widespread use, Hansen et al. (2003) describe budgeting as the "cornerstone of the management control process and nearly all organizations" (p. 95). However, by referring to academic and practical evidence, an evaluation shows there are too many limitations with the traditional budgeting technique, many of which make it incompatible with current organisational realities, resulting in firms abandoning the approach for 'beyond budgeting' or strategic budgeting techniques and tools to assist in the decision making, planning and control processes.

Most of the advantages of the traditional use of budgets are well-known and documented. Budgets are useful because they provide a method of control (Merchant, 1981). Management can follow the results, analyse the differences, which might be used to help managers understand the situation as it exists presently and change the course for the future. On the other hand, decision-making is not always viewed as a rational procedure (Mintzberg, 1998) executives are not like machines, able to calculate alternative, consequences and come up with an optimal decision. When framed in less rational terms, decision-making is often done, as Mouritsen and Kriener (2013) argues in "ambiguity, politics and complexity" (p. 21), which requires one to take into consideration bonded rationality, power and other variables that do not relate to data and financial objectives (March 1991; March 1997). Thus, the ability of the budget to aid in the process of decision-making is made immediately problematic when one considers the limitations of human cognition and the way that decisions play out in the real world.

Another major limitation of using budgets to aid in decision making is that the data produced is incapable of providing the information decision makers require to handle complex organisational dynamics (Hope & Fraser, 1997). A practical example is useful to illuminate. At Nestle, when the CFO, Jean-Daniel Luthi was working there in his early years some decades ago, communication was poor with subsidiaries in developing regions, making the annual budget a very critical tool to develop an understanding between headquarters and subsidies (Daum, 2005). It served as the platform to create plans and targets. However, and importantly, Luthi comments that in today's environment, where the macro environment in which the firm operates is unpredictable and subject to constant change, (because of globalisation, because of changes in consumer preferences, economic stability, changes in technology and phone), the budget is no longer an appropriate tool. Johnson (1992) made this argument in his work, Relevance Regained, suggesting that the insistence on using budgets to control business operations made American businesses lose competitive advantages because they failed to understand and appreciate the wider complexity of the business environment. In the process, they lost market share and lagged for decades after (Johnson, 1992).

Since the external environment (whether industry or macro related) is ignored, so too are competitor decisions and the future of the business, which limits the ability of the firm to generate sustainable advantages. It was this reason in fact in which the "externally oriented approach" (Abdel-Kader & Luther, 2006, p. 340) or strategic management accounting (Roslender & Hart, 2002) (which while there is no universally accepted definition (Roslender & Hart, 2003) has certain pillars like a focus on the competition and a forward-looking orientation) (de Waal, 2005) is proposed as a promising effective alternatives.. Because of this, using budgets is seen as being incompatible with providing the insights organisations need to compete in the knowledge/information economy.

There are other concerns. Budgets have also been identified as being too "rigid, detailed and annually focused" (Bourmistrov and Kaaboe, 2013), which means only is the data possibly outdated because budgets are infrequently conducted, but it can limit the ability of executives to be creative and reflective since they do not actively seek out input from employees on the front line. Nyland and Pettersen (2004) found that in the hospital setting, budgets were not perceived by leaders as important decision-making tools because of the failure of the relationship between budget and clinical actions (more important were the dialogue between the managers and individual clinicians in various departments, as the study found). This brings to the fore another concern with budgets that they do not take into consideration financial goals and objectives while making people feel undervalued (Hansen et al., 2003).

In addition, Kaplan (1984) argued many decades ago the traditional management accounting procedures were developed for mass and standardised organisations, and it is this orientation which facilitates "centralised command and control" (Bourmistrov and Kaaboe, 2013) in the first place. These systems are as such incompatible with the planning and control of contemporary organisations, many of which are flattened and assume a post-Taylorist/Fordist design (Boyns & Edwards, 2012). It is for this reason many have claimed budgets are inward-oriented and may serve as a barrier to achieving innovation or generating creativity. On the other hand, there has been evidence produced in the past (Simons, 1987) that some organisations, like Johnson & Johnson, have relied extensively on budgeting even though they are innovative and operate in an innovative industry.

Traditional budgets also fail to take into account some of the changes in manufacturing technology (Kaplan, 1983), which enables organisations to increase their productivity, flexibility, and quality. Also, budgets tend to be captive to financial reporting, resulting in "damaging short-termism" (Roselender, 1996, p. 536) and a problematic cost allocation technique, i.e., a single cost system, which did not provide much value to management. These problems are not lost among management accounting scholars, where there emerged of 'relevance debate' (Johnson & Kaplan, 1987) throughout the 1980s and early 1990s. Alternatives where envisioned, including the outward-looking, strategic approach to management accounting as well as among others activity based costs accounting (Roslender, 1996).

In fact, because of the limitations many corporations, as it is assumed and in some cases empirically shown (though evidence here is admittedly scant;) (Libby & Lindsay, 2010), have either entirely or partially abandoned the traditional budgeting technique and use a variant of what has been called 'beyond budgeting.' These include activity-based costing (ABC), activity-based budgeting (ABB), flexible budgeting, and more. In this model, the centralised structure is discarded, and a decentralised one opted, with self-managing units where decisions are made "on the frontline" so that it is possible to respond more easily to changes in the market or related to customers (Libby & Lindsay, 2010). With this model, too, managers are generally empowered, meaning they can act using their discretion. For organisations that have not embraced the change, it may be because, as Neely (2001) explained, they are "a centrally coordinated activity, often the only one, within the business and constitute the only process that covers all areas of organizational activity" (p. 9). So it is possible that traditional budgeting techniques may exist still, even despite all the limitations that have been discussed above.

A critical analysis of the traditional budgeting technique shows that while it was initially perceived as a useful tool in which to guide decisions, it was created in an environment that is very different from today's organisational realities. Globalisation, the rise of various manufacturing technologies as well as the need to evolve with the trends in the external environment, does seem to require different initiatives. Some organisations may opt for a balanced scorecard technique, while others may turn to total quality management are to be based on costing. It is difficult to say to what extent the use of the budget has been entirely abandoned, but it does seem that there is relative agreement from the traditional approach is not useful for current organisational realities.

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