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Degree in Finance from Nova School of Business and Economics

The design and use of annual budgets to cope with uncertainty

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Abstract

For centuries, annual budgets have played a central key role in most organizations serving the main purposes of planning and control. Yet, more recently the budgeting practice has been subject to severe criticisms, among which stands its ineffectiveness to deal with uncertainty. In order to avoid some of the major problems associated with the preparation and usage of budgets, two alternative approaches have been proposed: Better Budgeting and Beyond Budgeting.

This study aims to understand which factors companies perceive as uncertainty, and how budgets, either in their traditional form or through new approaches, might be able to help companies deal with them. To do so, two companies with different dimensions, operating in different business sectors and thus subject to different economic contexts were analyzed.

Evidence collected seems to indicate that companies are indeed taking a new approach to budgeting, either simplifying it or complementing it with other techniques. The Balanced Scorecard, due to its capacity to link the short with the long-term strategy as well as to link different perspectives of the companies, comes up as one of the most useful techniques to complement budgets to face uncertainty.

Key Words – Budgeting, Annual Budgets, Better Budgeting, Beyond Budgeting, Management Control Techniques, Uncertainty.

1. Purpose of the Project

According to Johnson and Kaplan (1987), most of the management accounting (or also called managerial accounting) techniques were developed until 1925 to serve the informational and control needs of the managers of increasingly complex and diversified organizations. However, since then, globalization and the shift from standardized to tailored-made products, which led to the empowerment of not only the clients but also the suppliers, have made the business environment much more unstable and uncertain. In order to keep track with these changes, management practitioners had to evolve as well, moving from a traditional mechanistic approach, i.e., product-oriented, to a so-called post-mechanistic approach. The latter is customer focused and takes advantage of new management accounting techniques (Wickramasinghe and Alawattage, 2007).

One of the traditional techniques used in managerial accounting is budgeting, which was conceived in the XVIII century by the English Government to control its expenditures and later adopted by companies to plan their operations and control their performance. Yet, budgeting has been the center of much criticism lately (Barrett 2007, Hope and Fraser 2003, Østergren and Stensaker 2011). In fact, according to one major survey carried out by the Economic Intelligence Business Report (2000), top managers identify the reform of budgeting as one of the top priorities in their agendas.

Despite these criticisms, most organizations do recognize that budgeting is still a key element in their management control systems (Hansen et al. 2003; Libby and Lindsay, 2010; Cardoso, 2011). Yet, some companies realized that traditional budgets alone weren't adequate to the requirements of a more demanding business environment (Neely et al. 2003, Rickards 2006). This led those companies to adapt or complement the traditional process of budgeting with other managerial techniques, thus

implementing what is known as Better Budgeting (O' Sullivan, 2010). Other companies decided to go Beyond Budgeting by abandoning it and implementing instead a lean control system based on few market-oriented performance indicators and the usage of Balanced Scorecards (Rickards, 2006).

All managerial accounting techniques are subject to criticisms by academics and practitioners. However, they both argue that, depending on the context in which the company operates the implementation of management accounting and control techniques might bring benefits for the competitiveness of the company, in particular when facing an increasingly turbulent business environment.

Therefore, the purpose of this Work Project (WP) is to answer the following research questions:

1. How do companies perceive/define uncertainty in their business environment?
2. Do companies use budgeting to plan and control their activities for the next year? If so, how and why?
3. Why do companies use other techniques to complement annual budgets?
4. How do these techniques help the companies to deal more efficiently with uncertainty?
5. How do companies consider the evaluation process of their managers taking in to consideration the turbulence in the business environment?

In the next section the literature review which led to the definition of the former research questions will be presented.

2. Literature Review

Organizations are constrained by their associated uncertainties. In order to face them, corporate strategies should focus not solely on products and customers but also on technological advances, suppliers, competitors and other entities such as governmental

and juridical, with which organizations interact. These elements have been defined as the main components of the external environment and are, therefore, sources of environmental uncertainty (Duncan, 1972; Pfeffer and Salancik, 2003). Six major factors that companies perceive as uncertainty have been identified: 1) suppliers' actions, 2) customer demands, 3) competitors' actions, 4) availability of credit and interest rate changes in the financial markets, 5) changes in the government regulatory bodies and 6) union labor actions (Ezzamel, 1990). Thus, in order to face this uncertain environment, managers needed to develop and apply managerial techniques to help them to plan their activities and control their businesses.

Umapathy (1987) argued that the only managerial process that can translate qualitative mission statements and corporate strategies into plans, link the short and long term strategy, as well as bring together managers from different hierarchical areas, is budgeting. Otley (1992) and Becker, Messner and Schäffer (2010) also recognize that companies look to this process as very important for planning, control and performance evaluation. Also, a study carried out by Hansen and Van der Stede (2004) found that organizations have different potential reasons-to-budget that occur in different contexts, stating that the most common are operational planning, performance evaluation, communication of goals and strategy formation.

Despite the multiple purposes/roles of budgets¹, there might be the danger that they (the roles) conflict with each other (Drury, 2008). Becker (2011) argued that companies are increasingly becoming dissatisfied with the value delivered by the annual budget since its numbers are quickly outdated and often useless for control purposes. In addition, Neely, Bourne and Adams (2003) stated that traditional budgeting² is too time consuming and costly, does not respond to today's competitive and turbulent

¹ Planning document which coordinates the various activities of a company for future periods, normally a year. Also serves other purposes such as performance evaluation and control.

² As opposed to better or beyond budgeting defined earlier.

environments, is counterproductive because it's usually affected by gaming, corporate politics and horse-trading tactics, is rarely strategically oriented as it focused on cost reduction instead of value creation, often represents a barrier to change, reinforces departmental barriers, is not revised frequently and strengthens vertical command and control.

To solve some of these problems, Hope and Fraser (2003) and O'Sullivan (2010), encouraged companies to abandon budgeting alleging that it reinforces vertical empowerment. Also, they argued that in an empowered organization, every manager is free to make mistakes and at the same time to fix them which reduces the decision-making process time. What Hope and Fraser (2003) advocated is what is called Beyond Budgeting by Rickards (2006), but this author also identifies another alternative approach to traditional budgeting: Better Budgeting.

The Better Budgeting process focuses on improving the functional and institutionalized roles of budgeting (such as planning and control) through the simplification of the traditional budgeting approach by reducing the number of planning objects, and budgeting only for those businesses processes (for example production or purchases) deemed crucial to the company's success (Rickards, 2006). Also, the Better Budgeting approach can be carried through the complementation of the budgeting technique with advanced managerial techniques such as: Activity Based Budgeting, Zero Base Budgeting, Value Based Management, Profit Planning, Rolling Budgets and Rolling Forecasts (Neely, Bourne and Adams, 2003).

According to Daum (2002), Beyond Budgeting stands on two types of principles: leadership and performance. The former is based on responsibility, where every manager is accountable for his/her own actions, whereas the latter considers KPI's (Key Performance Indicators) to manage the organization. In this scenario,

practices that might replace traditional budgeting include: Shareholder Value Models, Benchmarking, Balanced Scorecards, Activity-Based Management, Customer Relationship Management and Enterprise Information Systems (Player, 2003). In the particular case of the Balanced Scorecard, Busco and Quattrone (2011) argued that the reason behind its widespread diffusion is directly connected to its capacity to establish causal relationships and express them visually.

Oilco, Svenska Handelsbanken, Borealis, Unilever, Rhodia, UBS AG, UPS, BASF-IT Services and German Railways are a few examples of organizations that completely abandoned budgets and went Beyond Budgeting (Østergren and Stensaker, 2011, Rickards, 2006; O'Sullivan, 2010). Yet, this is not the most common case. As Libby and Lindsay (2010) and Cardoso (2011) identified through their surveys to both US and Portuguese companies, the tendency is to adopt the Better Budgeting instead of the Beyond Budgeting approach.

Based on the literature review just presented, the research questions for this WP were defined and the following section describes the process through which these research questions were addressed.

3. Methodology

Two qualitative (explanatory) case studies were prepared and done and the collected data examined to deepen our understanding of how and why companies use the budgeting technique, if they complement it (better budgeting) or move beyond it (beyond budgeting). This methodology explains the particularities of each company individually and considers the context in which each company operates (Ryan et al. 2002). Yin (2009) adds that case studies are preferred to surveys whenever how and why questions are posed and also when the research question seeks to explain some present circumstance. As to the usage of two case studies, Yin (2009) argues that the

data collected from multiple case studies is often more compelling, thereby making the research more robust than a single case study, since it allows either for replication or for contrasting results and conclusions, in other words, for a comparative analysis.

To select which companies to negotiate access to do this WP, a set of criteria was analyzed in the first place (Ryan et al. 2002). The criteria were as follows: activity sector, worldwide presence, net income and company accessibility. The first company selected, iTCo³, operates in the telecommunication services industry, characterized as a highly turbulent and fast developing one, while the second, Suber Group³, operates in the manufacturing sector, in a business that has been fairly stable and where the pace of product development is lower. Also, iTCo operates worldwide whereas the Suber Group has its major operations only in one continent, Europe. Therefore, there are significant differences in the size of these two companies. Finally, and knowing that companies are not always available to allow access to their information, the company accessibility was also a criteria taken in to account in the selection process.

To study the two companies and gather the testimonies of their collaborators, a semi-structured interview guideline was designed on forehand (see appendix 1). Archival analysis of documents, such as annual reports, performance appraisal sheets and an organogram of the company, was also accomplished.

The interviews were held at each company directly or by phone. Eight interviews to different collaborators in each company with different functions were carried out (see appendix 2) in order to gather various perspectives inside each company.

In the next section, the findings will be presented.

³ Disguised names for confidentiality reasons.

4. iTCo – Case Study

Organization Overview

Founded in Stockholm, Sweden, approximately a hundred and thirty years ago, iTCo operates in more than 84 countries and has over 82,500 employees worldwide. This organization operates in the telecommunication services industry business, providing communication networks, telecom services and multimedia solutions to companies (B2B). In 2010, net income was around 1,5 Million Dollars, and the most significant markets for iTCo were the USA (23%), China (7%), Japan (5%), Italy (4%) and the Iberian Peninsula (4%).

Since its creation, iTCo has registered more than 25,000 patents in electronic systems as well as software. The company estimates that approximately forty percent of the world's mobile traffic passes through its network.

Being a publicly traded company, iTCo has stocks listed on both NASDAQ OMX Stockholm and NASDAQ New York with a market capitalization of approximately 36 Billion Dollars.

Organizational Structure

iTCo's corporate headquarters are located in Stockholm. Due to its worldwide presence and the need for specific decision making in each country, the company has a hierarchical, yet flat, structure, firstly divided in continents and secondly in regions. Each region is then separated in Customer Units following geographical criteria and similarity in the market needs of its customers. Every Customer Unit is composed by four divisions: Head of Sales, Operations, Engagement and Support (see appendix 3). The Customer Unit in itself is considered an investment center since it has autonomy to decide on its own investments. Both Sales and Operations are profit centers due to the capacity of their managers to influence revenues and costs. Engagement and Support are

considered cost centers since they generate no direct revenue and thus their managers are only responsible for the costs under their control.

This organizational structure was designed to allow fast decision making in each Customer Unit. Every divisional manager is just two steps away from his/her superiors in the corporate headquarters and this allows for an easier and faster communication.

For the purpose of this WP, the focus will be on the Iberian Peninsula Customer Unit which is responsible for selling and operating iTCo's products and services, but neither for research nor production.

Target Setting

Targets are set through a negotiation process between the Iberian Peninsula Customer Unit and iTCo's corporate headquarters. The first step towards this negotiation is the analysis of two essential documents: the Growth Plan and the Business Plan.

iTCo – Iberian Peninsula only operates in the business-to-business (B2B) market which allows this customer unit to keep an extensive record of every customer. In this record, quarterly, annual and social responsibility reports, as well as other privileged information, are compiled. Through the analysis and discussion of these documents, carried out by the Marketing and Financial departments, as well as by the Head of Sales division, strategic tendencies and needs of the customers are predicted. Then, a five year commercial plan, called Growth Plan, is prepared, which states the targets in terms of products and services iTCo intends to sell to its customers over the next five years. In order to achieve these targets, a yearly Business Plan is prepared. The Business plan is a detailed report consisting in a sales budget per client where the annual sales targets to be achieved are identified, as well as which strategy to follow in order to achieve them, according to the Growth Plan. This report is signed by the Key Account Manager of

each client, thus committing her/him to the targets in the sales budget. The sales target defined in the Business Plan for each client will integrate the annual budget of iTCo - Iberian Peninsula as part of the sales component. Once the sales component of the budget is prepared, the costs component is defined through the usage of the Activity-Based Budgeting.

In addition, iTCo – Iberian Peninsula prepares a Balanced Scorecard with three perspectives: Financial, Customer and Employee. The Financial perspective has 3 KPIs: Orders Booked, Sales and Gross Margin, while the Customer and Employee perspectives have 2 KPIs each: Client Satisfaction and Number of New Business Contracts for the Customer perspective, Training Hours and Employee Satisfaction for the Employee perspective.

The Client Satisfaction KPI is measured through a questionnaire called CSI (Customer Satisfaction Index) and provides important feedback as to the willingness of the client to engage in future contracts. By comparing this indicator with the one in Number of New Business Contracts actually closed with the clients, iTCo – Iberian Peninsula is able to investigate which aspects need to be revised. As to the Employee Satisfaction, it is measured by a questionnaire named Dialog. Since the telecommunication services industry is extremely competitive, know-how is heavily rewarded and so iTCo needs to monitor closely the satisfaction of its employees to ensure they do not move to one of its competitors.

Communication of Targets and Management Appraisal

Besides preparing the annual budget and the Balanced Scorecard of the Iberian Peninsula Customer Unit, its divisional managers have access to a list of their personal objectives which are agreed in the negotiation process between the Customer Unit and iTCo's corporate headquarters. These objectives are divided in three components:

Customer Unit objectives (50%), divisional objectives (30%) and personal objectives (20%). These three objectives are used to determine the amount of variable remuneration of the top and middle managers.

In order to evaluate the performance of the managers and bestow them with a fixed salary raise, iTCo designed an evaluation process which measures subjective indicators such as the ability to cooperate, commitment to the job and punctuality (see appendix 4). The whole evaluation process is considered fair, even considering the turbulence in the economic environment, as explained by Iberian Peninsula iTCo Key Account Manager of Vodafone Portugal:

“... One thing is the variable remuneration, there you are measured by your capability of closing a deal, and another thing is your evaluation. You might be a great salesman and close good deals, yet you might be considered a bad worker or vice-versa...”

Uncertainty

For the Iberian Peninsula Customer Unit uncertainty takes many forms and affects this unit in the short-term, as well as in the long-term. Concerning the short-term uncertainty, factors such as the actions of the competitors, the general economic conditions, credit availability and the investment capacity of the clients, might disrupt the Business Plan and therefore the sales targets assigned for that year. In the long-term, the pace of development of the products and services by iTCo, the political cycles in the Iberian Peninsula and the growing complexity of the information technology business are considered as the most important sources of uncertainty.

To face this uncertainty, iTCo decided to finance directly its customers (to give them a credit line) on the products and services they acquire from iTCo. In this way, the uncertainty connected to lack of credit availability is minimized. To fast develop new products, iTCo made several partnerships with other companies which provide complementary services or products.

Management Accounting and Control Systems

Being a company operating in an extremely competitive market, iTCo makes use of advanced managerial techniques. Particularly, the management of the Iberian Peninsula Customer Unit is carried out through better budgeting. Although iTCo – Iberian Peninsula still prepares annual budgets, both Rolling Forecasts and Activity Based Budgeting are used to more accurately prepare them.

As explained by the Business Controller/Finance Director, in a business where the price of products and services are set by the market, Activity Based Budgeting is crucial to accurately predict costs in order to manage the margins:

“...since we use labor hours as the allocation unit of costs from the activities of the support divisions to the other divisions, we can accurately predict our needs and therefore manage our margins accordingly. This instrument has enhanced our competitiveness and has facilitated the pricing of our products. In this kind of competitive business, that practice is a must ...”

Rolling Forecasts are also being used at iTCo – Iberian Peninsula. When annual targets are set by the end of January, quarterly targets are also defined. Although there is a follow-up carried every month to every client, the Financial department uses the Rolling Forecasts to predict if the targets defined in the annual budgets are reachable or not. By incorporating the information from previous months on to the forecast and analyzing the different components of the budget, iTCo - Iberian Peninsula can quickly identify which components explain the difference between the budgeted figures and reality, thus allowing for an easier and quicker analysis.

The divisions have different perspectives regarding the Balanced Scorecard's utility. For the Key Account Manager of Portugal Telecom the Balanced Scorecard is very useful as:

“... besides the definition of the KPI's, the Balanced Scorecard allows us to have an idea of what we have to do in order to achieve our targets. It is very important to understand which way we have to go in order to succeed...”

Yet the Business Controller/Financial Director of iTCo – Iberian Peninsula has a quite opposite opinion:

“I’m a little skeptic about the usage of the Balanced Scorecard. I recognize its importance to define the KPI’s, but I do not acknowledge its power to establish causal relations. There are various ways to reach our targets...”

When used as complements, the Balanced Scorecard and the annual budgets are considered fairly effective tools to deal with the uncertainty of the business environment. While the annual budget is strictly financial and is able to translate short-term strategy into action, the Balanced Scorecard is able to implement and monitor long-term strategy providing crucial feedback about the needs of the market.

Motivation and Management Control

More than a management tool, annual budgets are a motivating instrument in a turbulent economic environment. The Marketing Expert (Marketing Manager) explains:

“The budget is a mix between reality and commercial ambition. Since our budgets already contemplate most of the available information of the customers and of the economic environment, the targets are fairly reachable, and that motivates the employees to give their best.”

The management control is carried by comparing the actual results with the budgeted figures (i.e, analyzing variances). After the comparison, the managers ascertain which aspects need correction and carry procedures to correct them.

5. Suber Group – Case Study

Organization Overview

Founded in 1870, the Suber Group started out as a small family owned company to serve the local wine industry in Portugal. Over more than a century the group expanded substantially in terms of business and internationally (mainly in Europe). In 2005, a major restructuring of the group was carried out by its Executive Committee in order to consolidate various assets in the textile, wine production, services and

infrastructure's businesses where the group was operating. Furthermore, by 2008 the group created a holding company with the purpose of acquiring stakes in other companies. The group is quoted in the PSI-20 and has a market capitalization of approximately 148.960 Million Dollars.

Organizational Structure

The Suber Group is organized in Macroareas, two of them being composed of Business Units (see again appendix 5). Since the group sells a wide range of products, holds a wide range of stakes in other companies, and has its own cork research, it would be very difficult for the group to apply a centralized control. Thus, the Executive Committee had to decentralize, empowering lower level managers. Also, the market in which this group has its core business is very competitive, meaning that every day difficulties arise and thus fast decisions have to be taken. As such, the group has decided to organize itself around the values of responsibility and flexibility as the Financial Director and Business Controller of the organization notes:

“Flexibility is what makes us a modern and dynamic organization; responsibility is what leads us to do our best.”

Target Setting

The target setting in this group is a fairly simple process. Both budgeting and the Balanced Scorecard are used to define the annual sales targets. The process of defining the sales targets starts at the top of the organization. Since every Business Unit manager has a deep understanding of the market in which it operates, he/she has to be aware and prepared to approach any new opportunity.

In the beginning of the year, usually by mid January, a meeting between all the Macroareas, Business Unit managers and the Executive Committee of the company is held. During this meeting every Business Unit manager presents the sales targets which

they pretend to accomplish in that year, as well as a budget for the operational costs based on the historical costs and a margin (incremental budgeting).

The presentation of the sales targets is followed by a thorough explanation of how to achieve them. Once the targets are fully approved and debated by all meeting representatives, both the budget and the final targets are disclosed through the whole organization.

The definition of the KPI's for the Balanced Scorecard is carried out by both the Board of Directors and the Executive Committee. The Balanced Scorecard has four perspectives: Financial, Customer, Internal Processes and Employee. Each perspective has three performance indicators which are monitored annually. As examples of KPIs for each perspective the company establishes: Financial – Residual Income, Market – Number of new contracts, Internal Process – Manufacturing Contribution Margin and Employee – Hours of training.

Communication of Targets and Management Appraisal

Once the targets of the Balanced Scorecard and the budget are communicated, every Business Unit manager has its own individual goals. Although there is not a formal process of attribution of variable remuneration, the managers receive a bonus when they surpass the sales targets they have committed to achieve in the annual budget.

The management appraisal is directly connected to the target setting as well. If the managers are able to surpass their own targets, they are considered as being effective in their job. Yet, in case any manager does not achieve or surpass its target, there are no defined punishments. Instead the Executive Committee analyzes the underlying cause of the poor performance and comes up with solutions and corrective actions to prevent further low performances.

Uncertainty

Since the core business of the company (cork stoppers), which generates approximately 59% of the revenues, is closely connected to the wine industry, the factors that most represent uncertainty to the Suber Group are: the actions of the competitors, unemployment, the added value taxes, the level of stocks and the economic environment. Yet, these factors have changed recently as noted by the Financial Director and Business Controller:

“Not so long ago, we were highly dependent from external financing. Around 2005, we aimed at reducing that dependence and I personally believe that we have made a good job... what really worries me now is our level of stocks...”

In order to face uncertainty as just described, the organization has developed several entrepreneurial activities. The Supply Chain Manager argues:

“I personally believe that there is only one way to minimize uncertainty: to explore new markets and, if possible, new countries. Every country needs cork, in some of them the market is already saturated by our competitors but there is a whole world out there, we just have to be aware of possible opportunities...”

Annual budgets are regarded as a fairly effective tool to face uncertainty when complemented with the usage of the Balanced Scorecard. The price of cork is directly influenced by the volume of cork extracted from the trees, thus there might be variations from year to year in the price of finished goods (i.e., cork stoppers and components). Yet, over the years, the Suber Group has bought land and invested in equipment, in order to ensure a stable cork production and supply, thus, turning the budget figures for production amounts (tons) and costs more adjusted to reality. With the usage of the Balanced Scorecard, the company is able to more accurately estimate the sales figures in the annual budget to accomplish the desired residual result. Also, the extraction of cork from the trees is an activity which requires many expertise and training, and this is where the Balanced Scorecard also becomes a very useful tool.

Management Control Systems

Despite being a highly internationalized organization and worldwide leader in cork production, as well as of its derivatives, the budget is prepared based on only two inputs: sales and an historical analysis of costs.

Also, the company uses traditional costing systems to determine the costs of its products since the investment required to implement IT systems for Activity Based Costing is very high when taking in to consideration the possible advantages. As the Financial Director and Business Controller stated:

“... the truth is that, although Activity Based Costing is a powerful tool, it would not serve its purpose in this organization. The investment costs are too high to compensate its purpose...”

The sales targets defined in the beginning of the year, through the preparation of the annual budget, are revised every semester. This process goes by the name of Rolling Plan and the reason behind the revision is not to change the annual target proposed, but to monitor the capacity of achieving it, since the Business Unit managers are still evaluated through the annual targets.

The major disadvantages of using budgeting as a managerial practice identified by the company are: the time required to prepare the budget and its slowness in reacting to a new event. Also Suber Group adopted the Balanced Scorecard though it is neither considered a perfect instrument. As a general opinion, the usage of such management accounting and control tool is only effective in monitoring long-term strategy as well as establishing an effective connection between the different Macro-areas.

As to the causal relationships, the Balanced Scorecard is considered ineffective. According to various managers, there are innumerable ways of achieving a target and so, the design of causal relationships between objectives and KPI, consumes too much time and effort. The Commercial Director explained that:

“ ... any manager knows that by either increasing the margins or the quantities sold we can achieve better results. The most important thing to do is to know each client from top to bottom, identify areas where we can be useful and visit them regularly so that they know we care about them...”

Motivation and Management Control

Since each Business Unit manager is responsible for setting its own targets, the budget is considered a very motivating practice as mentioned by the Commercial Director:

“One thing we have to understand is that we have to be realistic about our targets. If they are too low, the Executive Committee will refuse, if they are too high we might not reach them. As long as we define a realistic target the budget is an extraordinary tool.”

The management control process is done based on two different ways: 1) the analysis of the variances between what was budgeted and actual results; and 2) the analysis of the KPI's from the Balanced Scorecard.

The first provides vital feedback information as to the performance of the company during that year, while the analysis of the KPIs from the Balanced Scorecard provides crucial information about long-term strategy.

These findings are now discussed.

6. Discussion of Findings

In order to analyze the differences between the two case studies, the following summary table was prepared:

Table 1 – Summary of the similarities and differences between the two companies.

Company	iTCo	Suber Group
Uncertainty		
Main Factors	General Economic Conditions Political cycles Growing Complexity of the Business Competition Investment Capacity of Clients Pace of Development of Products	Unemployment Economic Environment Competition Added Value Taxes Level of Stocks -
Annual Budget		
Prepare	Yes	Yes
Effective	Fair	Fair
Main Advantages	Visual idea of what to achieve Understand the strategy to follow	Clear objectives Motivates the managers
Main Disadvantages	Focus on the short-term Quickly falls out of date	Too time consuming Slow to react in case of a new event
Advanced Managerial Techniques		
Better Budgeting	Yes	No
Which One(s)?	Balanced Scorecard Rolling Forecasts Activity Based Budgeting	Balanced Scorecard Rolling Plan Incremental Budgeting
Management Evaluation		
Instrument	Annual Budget and Balanced Scorecard	Annual Budget and Balanced Scorecard
Is it Adequate?	Yes	Yes

As expected, the two companies consider different causes of uncertainty (see Table 1) and thus have different uncertainty perceptions. However, both companies pointed competition as one of the most important sources of uncertainty, indicating that despite the business in which companies operate, or their dimension, competitions have power to disrupt their plans.

Both companies still define annual budgets and, despite differences in the budgeting processes, the two companies consider as the most important reasons-to-budget planning, targeting setting and control. Also, both companies stated using the Balanced Scorecard, fact which indicates that when combined with the Balanced Scorecard, annual budgets are a fairly effective tool to deal with uncertainty and that they have adopted the Better Budgeting approach.

As to the main advantages and disadvantages of using annual budgets the two companies have different perceptions. These perceptions are connected to the advanced managerial techniques each company adopted to complement the annual budget. While

the Suber Group considers the traditional budgeting process too time consuming and therefore simplified the cost component through the usage of incremental budgeting while complementing the process with the usage of Balanced Scorecards, iTCo considers that annual budget figures quickly fall out of date and use Rolling Forecasts to more accurately define them.

The techniques used by both companies clearly indicate differences in their budgeting approach. While iTCo uses both Rolling Forecasts and Activity Based Budgeting and therefore is clearly in a Better Budgeting process (cf. Rickards, 2006) as stated before, the Suber Group is also undergoing a change in the budgeting process. Indeed, this company is currently in a Better Budgeting process, derived through the simplification of the budgeting process to define the cost component and its complementation with the Balanced Scorecard to define the sales targets. Yet, the difference as to the definition in the budget components, along with the fact that Suber Group stands by the two principles of the Beyond Budgeting (leadership and performance) might indicate that the company is steering towards a Beyond Budgeting approach.

Finally, both companies use the same techniques to evaluate the performance of their managers, thus regarding these techniques as fair performance evaluation system, despite of the uncertainty of the business environment.

7. Conclusions

From the analysis of the case studies done in this WP some conclusions can be drawn as to how companies prepare budgets as well as why they prepare them and which techniques they use. The first is that the usage of traditional budgets alone is not enough to effectively deal with the uncertainty of the business environment. Also, regarding uncertainty factors, we can see that two new uncertainty factors have been

identified: the level of stocks and the investment capacity of the clients (Ezzamel, 1990).

Despite some of the criticisms of annual budgets, companies still use them to plan their activities for the next year as well as to execute the performance appraisal. Yet, they either complement the preparation of the budgets by using other managerial techniques or simplify it by using techniques such as the incremental budgeting, which corroborates the research from such authors as Cardoso (2011), Libby and Lindsay (2010) as well as Hansen et al. (2003). Furthermore, this WP adds to the reasons previously stated as the main advantages of using these advanced managerial techniques on an uncertain environment, mainly derived from their ability to deal with effects from the actions of the competitors. As such, the Activity Based Budgeting plays a central role in the decision making process due to its ability to predict costs with high accuracy and manage the margins accordingly, which might explain the increasing usage of this technique in various companies analyzed by the previously stated authors. Also the usage of Rolling Forecasts saves both resources in the preparation of the budgets as well as in the following comparison analysis between what was budgeted and the real performance.

Moreover, companies tend to complement annual budgets with the usage of the Balanced Scorecard, due to its capacity to monitor various perspectives such as Financial, Growth, Employee and Internal. Due to this fact, the Balanced Scorecard is able to establish a link between the short-term and long-term strategies mainly due to the links between the first two perspectives, which goes against what Umapathy previously stated back in 1957.

Yet, the causal relationships that Kaplan and Norton (1996) state that must exist between the objectives and performance indicators of the Balanced Scorecard seem very

hard to be established as there are innumerable forms to achieve the same targets. This was clearly stated by the interviewees in both companies selected for this WP, which diminishes the usefulness of the Balanced Scorecard and therefore differs from what Busco and Quattrone (2011) concluded in their study.

Another conclusion that can be drawn from the analysis of the two case studies is that the companies create their own instruments and mechanisms such as the credit line or the entrepreneurial activities to minimize the impact of uncertainty in their specific contexts. Also, due to their dimension and the uncertainty of the business environments in which they operate, the studied companies are forced to flatten their organizational structure and decentralize the decision making power, thus developing control systems which are transposed to the entire company.

Finally, the findings of this WP should be interpreted taking into account the methodology that was followed: case studies. Yet, this methodology approach allowed the identification a company that seems to be in a hybrid process between Better Budgeting and Beyond Budgeting, case that could not be identified through other studies such as Cardoso (2011). Future research should be held in order to verify if whether these findings apply to other companies with similarities in their characteristics such as dimension and activity sector.

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Appendix 1 – Model of Interview

Grupo I

- 1 – Tendo em consideração a empresa como um todo, que factores do meio envolvente geram, na sua opinião, maior incerteza para o negócio da mesma? Turbulência e incerteza são sinónimas para si? Porquê?
- 1.1 – Em que medida dos factores anteriormente identificados afectam o planeamento das actividades para o futuro?
- 1.2 – A organização em que colabora prepara algum tipo de orçamento? Se sim, qual?
- 1.3 – Se respondeu afirmativamente na pergunta anterior, qual a sua opinião sobre o papel que os orçamentos podem desempenhar para lidar eficazmente, com os factores definidos anteriormente, como geradores da incerteza no meio envolvente da sua empresa?
- 1.4 – Na sua opinião, quais as maiores fraquezas do orçamento no que respeita à gestão da incerteza proveniente do meio económico? E as maiores vantagens? Porquê?
- 1.5 – A sua empresa utiliza outras técnicas para além dos orçamentos para lidar com a incerteza do meio envolvente? Quais?
- 1.6 – Considera-as eficazes para lidarem com a incerteza do meio económico? Porquê?

Grupo II

- 2 – Como é que são definidos os objectivos estratégicos da empresa?
- 2.1 – Tendo em conta as diferentes técnicas de gestão mencionadas no Grupo I, como é que elas são utilizadas na definição dos objectivos estratégicos?
- 2.2 – Com que frequência é que são revistos esses mesmo objectivos?
- 2.3 – Que vantagens confere à empresa a utilização das técnicas anteriormente identificadas?
- 2.4 – Em relação à elaboração e utilização de orçamentos, porque é que a empresa opta por utilizá-los (ou não) para definir os seus objectivos estratégicos?

Grupo III

- 3 – Como é que são comunicados os objectivos estratégicos aos diferentes departamentos?
- 3.1 – Como é que são comunicados posteriormente os objectivos aos colaboradores de cada departamento?
- 3.2 – Porque é que a organização decidiu utilizar (ou não) orçamentos como uma forma de comunicação?

Grupo IV

- 4 – O departamento em que colabora prepara orçamentos para planear as suas actividades? (se responder negativamente por favor prossiga para a pergunta 5). Como é que são elaborados os orçamentos no seu departamento? (descreva por processos se possível).
- 4.1 – Com que frequência são ajustados os objectivos desse orçamento? Na sua opinião, essa frequência está adequada à turbulência do meio envolvente? Porquê?
- 4.2 – Relativamente ao departamento com o qual colabora directamente, que técnica(s) de gestão é (são) utilizada(s) na elaboração dos orçamentos por forma a que estes reflectam o mais possível as alterações no meio envolvente? Qual a razão para a sua utilização?
- 4.3 – Como é que as diferentes técnicas são utilizadas em conjunto no planeamento das actividades? (descreva por processos, se possível)
- 5 – Se porventura os orçamentos não forem utilizados para planear as actividades do ano seguinte, que técnicas são utilizadas para o mesmo propósito? Porquê?
- 5.1 – Como é que a empresa usa as técnicas anteriormente identificadas para planear as actividades? (descreva por processos, se possível)
- 5.2 – Quais as razões para que a empresa tenha optado pela utilização da(s) mesma(s)?
- 5.3 – Qual a sua opinião em relação à utilização da(s) mesma(s) para planear actividades?
- 5.4 – Em que medida é que as técnicas identificadas diferem dos orçamentos em termos de planeamento?

Grupo V

- 6 – Como é executado o controlo do orçamento das unidades/divisões na sua empresa?
- 7 – E a avaliação do desempenho dos seus gestores?
- 7.1 – Tendo em consideração que existe muita incerteza no meio envolvente, considera que a forma como os gestores são avaliados é adequada? Porquê?

- 7.2 - Por que razão a empresa optou por utilizar as técnicas anteriormente identificadas como forma de avaliar os seus gestores?
- 7.3 - Na sua opinião, porque é que a empresa optou por utilizar (ou não) os orçamentos como forma de avaliação dos seus colaboradores?

Appendix 2 – Interviews made

Function	Date	Minutes	Method	Record
Business Controller / Financial Director	27-07-2011	100	Directly	Yes
Marketing Expert	04-08-2011	60	Directly	Yes
KAM* - Vodafone	29-08-2011	30	Phone	No
KAM* - Portugal	05-08-2011	40	Directly	Yes
Head of Operations	29-08-2011	60	Directly	Yes
Business Controller / Financial Director	17-11-2011	30	Directly	No
Human Resources Director	21-11-2011	15	Phone	No
Consulting Director	23-11-2011	15	Phone	No
Total		350		

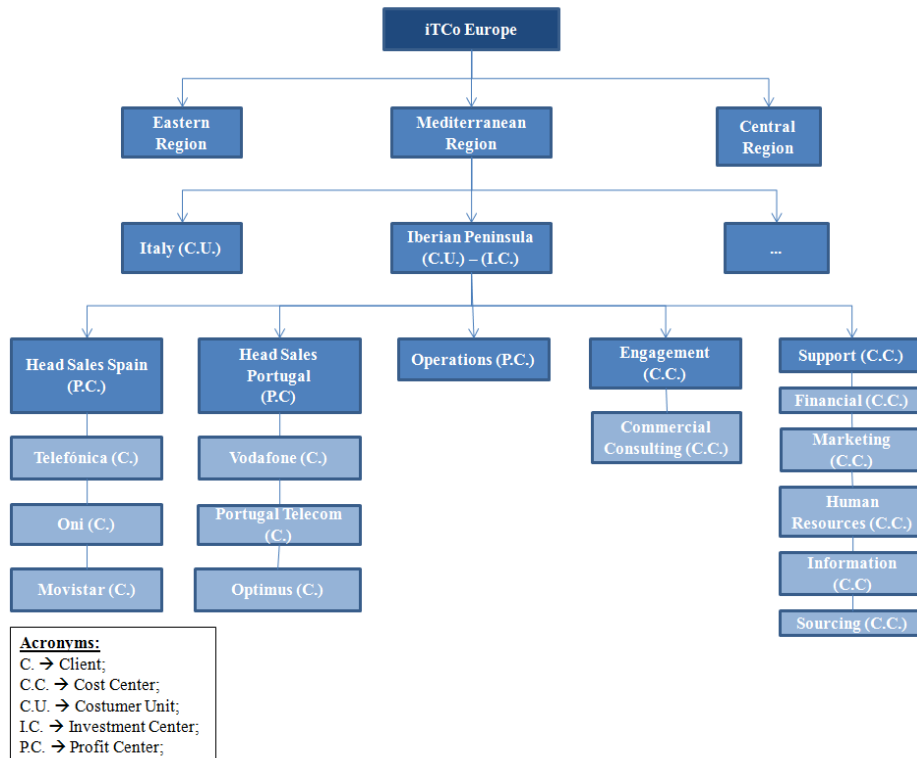
iTCo

Function	Date	Minutes	Method	Record
Business Controller / Financial Director	22-08-2011	70	Directly	Yes
Supply Chain Manager	22-08-2011	35	Directly	Yes
Commercial Director	22-08-2011	50	Directly	Yes
Business Controller / Financial Director	15-10-2011	40	Phone	No
Human Resources Director	22-11-2011	20	Phone	No
Production Manager	24-11-2011	40	Phone	No
Cork research Director	25-11-2011	25	Phone	No
Corporate Sustainability Manager	25-11-2011	30	Phone	No
Total		310		

Suber Group

*- Key Account Manager

Appendix 3 – iTCo's Organizational Structure



Appendix 4 – iTCo’s Evaluation Sheet Representation

Evaluation Component	Not Sufficient	Sufficient Minus	Sufficient	Good	Very Good	Scale	Salary Rise
Group Work						Very Good	3% - 5%
Commitment						Good	1% - 3%
Punctuality						Sufficient	0,5% - 1%
Average						Sufficient Minus	<0,5%
						Not Sufficient	0

Appendix 5 – Suber Group Organizational Structure

