Chapter 02: Section 01

Alternative Budgeting Approaches

Section 01: Alternative Forms of Budgeting

1. Traditional Budgeting Methods

1. INCREMENTAL BUDGETING

Incremental budgeting uses the previous period's budget or actual results as a baseline, then applies adjustments for expected changes.

Advantages: Simple to operate and understand, requires minimal resources, and provides budget stability, making it quick to prepare.

Disadvantages: Perpetuates past inefficiencies by carrying them forward, encourages a "spend it or lose it" mentality to protect future baselines, and lacks strong alignment with strategic objectives.

Suitability: Stable, mature organisations where cost structures are well-understood and the external environment is predictable

1. Traditional Budgeting Methods

2. Zero-Based Budgeting (ZBB)

Zero-based budgeting requires every expense to be justified from a zero base for each new period, rejecting historical precedent.

Advantages: Eliminates historical inefficiencies, forces a critical review of all spending, improves resource allocation by linking it directly to strategic priorities, and enhances accountability.

Disadvantages: Extremely time-consuming and resource-intensive, requires significant management training and effort, and can foster a short-term focus at the expense of long-term investment.

Suitability: New or small scale organizations or during periods of significant organisational change (e.g., restructuring, mergers), for major cost-reduction initiatives, or in public sector entities needing to justify all expenditures

1. Traditional Budgeting Methods

3. Activity-Based Budgeting (ABB)

Activity-based budgeting links resource allocation directly to the activities that consume them, using cost drivers—factors that cause changes in activity costs.

Advantages: Provides a more accurate and realistic budget, creates a clear link between costs and outputs, helps identify non-value-adding activities, and supports better decision-making on pricing and process improvement.

Disadvantages: Complex and costly to implement, requires sophisticated information systems to track activities and cost drivers, and can be difficult to apply outside of production-oriented environments.

Suitability: Organisations with diverse product lines and high overhead costs, such as manufacturing firms or service companies with varied service offerings.

1. Traditional Budgeting Methods

JMC ජයසේකර කළමනාකරණ මධ්‍යස්ථානය JAYASEKERA MANAGEMENT CENTRE (PVT) LTD Estd. 1972
Pioneers In Professional Education

4. Programme Planning Budgeting System (PPBS)

Programme planning budgeting aligns resources with specific programmes or projects that support long-termobjectives rather than traditional departmental structures.

Advantages: Ensures strong alignment between spending and strategic goals, improves long-term planning, enhances accountability for programme outcomes, and facilitates cross-departmental collaboration.

Disadvantages: Defining programmes and accurately allocating shared costs can be difficult, measuring outcomes is often more challenging than measuring inputs, and it may conflict with existing departmental reporting structures.

Suitability: Widely used in government and non-profit sectors to manage long-term projects and initiatives; also valuable for large corporations managing strategic programmes like new product development or market entry

2. DYNAMIC BUDGETING

1. Rolling Budgets

A forecast continuously updated by adding a further accounting period when the earliest expires.

Advantages: Ensures the budget remains relevant and forward-looking, increases organisational flexibility to respond to change, reduces end-of-year budget gaming, and integrates planning into a continuous management process.

Disadvantages: Requires significant and continuous management effort, which can lead to "planning fatigue"; may encourage a focus on short-term revisions at the expense of long-term strategic thinking.

Suitability: Essential for organisations in volatile or fast-moving industries (e.g., technology, retail) where conditions change rapidly, making static annual plans obsolete

2. DYNAMIC BUDGETING

1. Rolling Budgets

Accuracy Enhancement:

1. **Develop driver-based models** that link financial outcomes directly to operational metrics like sales volume or production units.

2. **Create multiple scenarios** testing optimistic, pessimistic, and base-case assumptions to understand potential outcome ranges.

3. **Apply statistical methods** or machine learning to identify patterns and trends in historical data

2. DYNAMIC BUDGETING

2. Kaizen Budgeting

Kaizen is a philosophy of continuous, incremental improvement involving all employees from managers to workers. Kaizen budgeting incorporates this concept into budgets.

Advantages: Fosters a culture of continuous improvement and employee empowerment, achieves sustainable cost reductions without disruptive cuts, and improves operational efficiency over the long term.

Disadvantages: Requires strong, sustained management commitment and a supportive culture; the incremental improvements may be insufficient to address a major financial crisis; can be difficult to apply to non-production or discretionary cost areas.

Suitability: Highly effective in manufacturing environments committed to lean principles and Total Quality Management (TQM), and in mature industries where competitive advantage is driven by operational efficiency

2. DYNAMIC BUDGETING

2. Kaizen Budgeting

Managing Implementation Challenges

1. Secure visible support from senior leadership to champion the new approach across the organisation.
2. Implement through a phased rollout, starting with a pilot department to demonstrate benefits and refine processes.
3. Provide comprehensive training and simplified templates to reduce administrative burden on participants.

2. BUDGETING SELECTION CRITERIA

1. Contingency – Based on the company circumstances/ situation
2. Environmental factors – Volatility, Competition, Technological changes, Regulations
3. Organizational characteristics – Scale, structure, resources
4. Strategies of the company
5. Cost-Benefit Analysis of the budgetary system
6. Supporting analytical tools – Budget decision matrix

2. BEYOND BUDGETING

A philosophy that seeks to replace budgeting. It is about interlocking leadership and process principles work together to create a decentralized, empowered, and highly responsive organization.

Leadership Principles	Process Principles
Purpose: Create a clear purpose	Targets: Goals relative to competitors or market leaders
Responsibility: Give ownership and accountability to teams	Rewards: Reward shared success
Autonomy: Empower front line teams to make decisions	Planning: Make planning a continuous and inclusive process
Organisation: Network of teams rather than centralized functional silos	Resources: Make resources available as needed based on valid business cases
Customers: Connect everyone's work directly to customer needs	Coordination: Dynamically coordinate interactions across the organisation
Transparency: Promote open information sharing	Controls: Base controls on real-time relative indicators and trends

2. BEYOND BUDGETING

Implementation Challenges

1. Cultural Barriers: overcoming a command-and-control culture.
2. Technical Hurdles: Establish integrated information systems that provide real-time, transparent data.
3. Organizational Resistance: Middle managers opposing beyond budgeting with the fear of losing controls

Develop a Phased Transition Plan

1. Design a pilot programme in a single, receptive business unit
2. Develop a hybrid model (an annual budget + rolling forecasts and relative targets)
3. Create a clear roadmap for expanding successful pilots

2. BEYOND BUDGETING

Implementation Challenges

1. Cultural Barriers: overcoming a command-and-control culture.
2. Technical Hurdles: Establish integrated information systems that provide real-time, transparent data.
3. Organizational Resistance: Middle managers opposing beyond budgeting with the fear of losing controls

Develop a Phased Transition Plan

1. Design a pilot programme in a single, receptive business unit
2. Develop a hybrid model (an annual budget + rolling forecasts and relative targets)
3. Create a clear roadmap for expanding successful pilots

2. BUDGETING APPROACH COMPARISON

- **Traditional Budgeting** is rooted in a command-and-control model, using a rigid annual process to enforce a fixed performance contract.
- **Better Budgeting** represents an evolutionary step. It accepts the budget's fundamental structure but seeks to remedy its mechanical flaws by introducing dynamic processes like rolling forecasts and flexible targets. The focus is on making the existing tool more accurate and relevant.
- **Beyond Budgeting** is a revolutionary departure. It rejects the budget entirely, along with the command-and-control model it represents. It advocates for a fully adaptive management model built on empowerment, trust, and decentralised decision-making.

2. BUDGETING APPROACH COMPARISON

Attribute	Traditional Budgeting	Better Budgeting	Beyond Budgeting
Core Philosophy	Command and control; a fixed annual performance contract.	**Evolution:** Improve the budget's mechanics and relevance.	**Revolution:** Replace budgeting with an adaptive management model.
Process	Rigid, annual, top-down cycle.	**Dynamic:** Continuous process using rolling forecasts.	**Adaptive:** Decentralised, event-driven planning and coordination.
Target Setting	Fixed, absolute, internally negotiated targets.	**Flexible:** Targets adjust to actual volumes or relative to benchmarks.	**Aspirational:** No fixed targets; relative goals against competitors/peers.
Resource Allocation	Fixed annual departmental allocations ("use it or lose it").	**More Flexible:** Still allocated, but rolling forecasts allow for updates.	**Dynamic:** Resources available on demand based on business cases.
Performance Evaluation	Variance analysis against a static budget.	Holistic review against flexible targets and KPIs.	Holistic review of relative performance trends; peer comparison.
Leadership & Culture	Hierarchical control; risk-averse; information is power.	Refines existing culture; focuses on process efficiency.	**Empowerment:** High trust, transparency, and accountability; coaching style.
Implementation	Established annual ritual.	**Incremental:** Phased projects (e.g., new software, rolling forecasts).	**Transformational:** Holistic, multi-year cultural and process change.