Elements and success factors for an efficient budgeting

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Abstract

A well-crafted efficient budget is believed to lead to an optimal financial performance. This research investigated the elements and critical determinants of efficient budgeting. We outlined how an efficient budget can lead to an optimal financial performance. By investigating the theoretical linkage between budgeting and financial performance, we found that there are five channels through which an efficient budgeting leads to an optimal financial performance. The channels are: a) communication and coordination b) motivator c) evaluation and control of performance d) goal Orientation e) cost awareness:

Introduction

Due to the complexities, uncertainties, and dynamics of the microeconomic and macroeconomic environments in which business activities are conducted globally in modern times, managers are compelled to employ some tried and true management techniques and tools to weather the storms of an ever-changing business climate (Rong et al. 2013) (Linder and Williander 2017). As a result, company leaders are continuously aware that numerous obstacles must be overcome in order to ensure the effectiveness and efficiency of their operations in order to maximize their earning potential and achieve total organizational success.

While there are numerous goals and finite resources, there is a strong tendency for the human factor engaged in the production of goods and services to squander or under-utilize the limited resources. In light of this, it is critical to conduct a realistic planning of the firm's activities, taking into account the firm's limiting factors and long-term objectives (Tian and Xu 2015). Budgeting — a planning and management tool – becomes important in order to do this. Budgeting is crucial and has long been viewed as a fundamental tool for business management.

A budget is described as a written statement of management's plans, goals, and objectives that encompasses all areas of operations for a specified time period (Shim et al. 2011) (Neely et al. 2003). The budget is a planning instrument that establishes goals and objectives. Budgets provide control over the immediate environment, assist in mastering the financial aspects of the job and department, and help in anticipating and resolving difficulties (Rasmussen et al. 2003; Jensen 2002). Budgets emphasize the significance of examining alternative actions prior to implementing decisions. A financial budget is a plan that is used to manage future operations and outcomes, and is quantifiable in terms of dollars, units, pounds, and hours. When budgeting is done correctly, it is a process that results in systematic, productive management. Budgeting enables greater control and communication, while also motivating personnel (Jensen 2002).

Budgeting allots funds to accomplish desired goals. A budget may cover any time period. It could be short-term (one year or less, as is frequently the case), intermediate-term (two to three years), or long-term (three years or more). Budgets for the short term include additional detail and specificity. Intermediate budgets analyze the company's present projects and initiate the programs necessary to accomplish long-term goals. Long-term plans are quite extensive in scope and can be converted to short-term plans (Barrett 2007). The budget period is determined by the budget's aims, intended use, and the veracity of the data used to produce it. The budget period is determined by company risk, sales and operating stability, manufacturing procedures, and processing cycle duration.

Efficient or effective budgets connect the non-financial plans and controls that underpin everyday managerial activities to the financial plans and controls necessary to achieve a satisfactory profit and financial position (Rasmussen et al. 2003.
Effective budgeting requires the following: & Predictive capacity & Transparent channels of communication, authority, and responsibility & Accounting-generated accurate, credible, and timely information & Information compatibility and understandability at all levels of the organization: upper, middle, and lower Tian and Xu 2015; Yan 2016; Hope 2015).

A correctly planned and effective budget enables a corporation to monitor its financial position on a continuous basis. This enables long-term strategic planning for everything from present operational costs to future expansion. Knowing the state of the budget enables the business to hire additional people, invest in new product lines, and align learning objectives with the organization's corporate financial objectives. Additional benefits include the following: a) The potential to attract investors; b) The ability to set sales goals; c) The ability to open lines of credit; d) The capacity to make decisions about salaries, bonuses, benefits, and overhead operating expenses; and e) If a business reports to a board of directors or an advisory committee, an in-depth budgeting process enables the business to provide f) consistent earnings representation (Horváth and Sauter 2004); (Schönbohm and Zahn 2012).

Elements of efficient budgeting system

The critical components of efficient budgeting can be categorized as follows Hurwitz 1996).

- Organizational structure
- Process structure
- Budgeting techniques

Budgeting systems' organizational structure establishes their institutional framework and serves as the foundation for an effective and efficient budgeting system. Budgeting organs are used to assess the organizational structure. Individuals or groups acting as budgeting organs participate actively in the budgeting process. Budgeting is overseen by the management board, which delegates certain functions. Because operational managers offer their skills to business development, line management is typically responsible for financial tasks. In comparison, service and formal responsibilities are carried out by specialist budgeting organs such as controlling, planning, and accounting departments Rasmussen et al. 2003; Lalli

2012). Nonetheless, duties are frequently not assigned as clearly in practice as the literature shows, complicating coordination and decision-making. Indeed, specialist organs frequently acquire financial responsibilities, while line management performs service functions.

The process structure outlines the chronological and logical order in which budgeting actions take place. Process-related norms are critical because they ensure the budgeting system, business planning, and leadership work together effectively (Ainsworth and Deines 2019. Vertical coordination is a term that refers to the collaboration amongst budgeting organs at various hierarchical levels. It occurs in three distinct directions: top-down, bottom-up, and counter-current.
Budgeting techniques entail the use of instruments and tools to aid in the planning and control of budgets. The three most often used techniques are given below Brown and Atkinson 2001.
• Analytical techniques, such as the determination of contribution margins and key performance indicators.
• Forecasting techniques, such as scenario development and decision trees
• Instruments for evaluation, including sensitivity studies and probability estimates.

Because budgeting techniques require accurate data entry, information technology (IT) is critical for ensuring the right supply, transport, and preservation of information (Rasmussen et al. 2003; . Informative databases, easily controllable user interfaces, and software are critical components of information technology systems (Strategies for successful budgeting 1990). Therefore, a significant emphasis should be placed on software, including enterprise resource planning (ERP) systems, spreadsheet programmers, and specialized planning tools in order to achieve an efficient budgeting system.

The determinants of efficient budgeting

It has been argued that business success is ensured by a small number of critical criteria. In the context of interdependent budgeting systems, the indicators of effective budgeting assist management in focusing their attention on critical issues. Additionally, researchers can assess and compare various types of budgeting. Certain experts cast doubt on the determinants' validity, despite the fact that the field has advanced significantly in recent years. For example, opponents assert that empirical studies frequently produce ambiguous or inconsistent findings, owing to the fact that a company's success can be influenced by a plethora of variables. However, outcomes from research conducted at a more operational level are encouraging. Studies identified a variety of potential factors of budgeting system efficacy and efficiency, as well as corporate success, including the following (Rose and Manley 2011):

1 high standard of information
2 The efficacy of information technology systems
3 budgetary intensity
4 involvement
5 strategy link
6 incentive links.

Determinants related to information supply assure the rationality of management decisions by providing suitable facts to support the decision-making process. One determinant is the reliability of the information. Coordination amongst budgeting departments is made easier with reliable data. Additionally, information quality acts as an input to the budgeting process by facilitating the usage of budgeting instruments (Chong et al. 2005). System quality is the second determinant. The term "information technology systems" refers to the information processing systems required to produce the budgeting process's output.

In terms of budgeting systems, information technology systems improve the quality of decision-making by budgeting organs, streamline the budgeting process, and make complicated instruments more accessible.

The determinants of result-oriented planning contribute to management's rationality by enhancing their leadership effectiveness. Budgeting intensity is one determinant that affects outcome-oriented planning. This variable denotes the investment of time and resources in the budgeting process. Increased intensity stimulates all budgeting organs to think through budgetary plans thoroughly and to effectively distribute budgeting tasks. Additionally, budgeting intensity is related to the level of detail in the budgeting process and the sophistication of budgeting instruments (Bergmann et al. 2020. The second determinant, involvement, quantifies the clout of the budgeting process's stakeholders. In divisional, decentralized organizations, a high level of participation is customary. Businesses, on the other hand, must allocate additional resources because increased involvement lengthens the budgeting process Kobelsky et al. 2008).

The determinant linked to management accounting's coordination function is derived from systems theory and seeks to enable rational decision-making by integrating the budgeting system with the rest of the organization's subsystems. (May 2017) Close coordination and communication between budgeting organs and strategy departments is critical in terms of the organizational structure of budgeting systems. In terms of budgeting system process structure, a close link to business strategy simplifies coordination and prevents time-consuming feedback loops.

Another determinant is concerned with the relationship between budgeting and incentive systems (i.e., the incentive link). Budgets are a component of performance measurement since they specify specific objectives with the intent of inspiring desirable behavior. By designing incentive systems effectively, budgeting organs can be induced to collaborate in order to increase coordination (Hansen and Stede 2004). However, if incentives are not properly aligned with budgets, financial slack emerges.

Impact of efficient budgeting on Financial Performance

1. Theoretical underpinnings

a) Cognitive Evaluation Theory.

According to this theory, when we assess a task, we assess it in terms of how well it satisfies our need to feel competent and in charge. If we believe we are capable of completing the task, we will be intrinsically motivated to complete it without additional external motivation (Deci et al. 1975). When a person's internal locus of control is greater, they will feel more in control of their actions. They will understand the environment or people have a bigger impact over what they do when they have a stronger external control.

Budgets instill a sense of accountability in the management responsible for a certain department or area. The sense of control over a department's results as a result of meeting budget targets can serve as a source of motivation and thus performance improvement. External rewards may be viewed as a means of gaining some kind of control over them, or they may be viewed as informational, as when they support emotions of competence and self-determination. When people perceive the reward as primarily for control purposes, they will be driven to obtain the prize rather than to improve the requested behavior.

This theory states that there are actually two incentive systems, intrinsic and extrinsic that relate to two kinds of motivators (Hamner and Foster 1975). The intrinsic motivation consists of accomplishments and accountability and is derived from actual performance and the task or work.

Pay, promotion, feedback, and working conditions are all examples of extrinsic motivators (Wiley 1997). These are external motivators that originate in a person's environment and are controlled by others. Individuals that are intrinsically motivated work for their own advancement and enjoyment. If they are performing a task solely for the sake of compensation, working conditions, or some other extrinsic motive, they begin to lose motivation.

Budget accomplishment is thus a strong intrinsic motivation because it fosters a sense of personal accomplishment and accountability (Zainuddin and Isa 2011). Achieving a budget target results in personal satisfaction, which boosts managerial performance.

b) Goal Setting Theory

According to goal setting theory, specific high (hard) objectives result in higher task performance than do easy goals or pause abstract goals such as the exhortation to "do one's best." (Locke and Latham 2013) (Lunenburg 2011).

A budget defines an organization's objectives for a specified time period. The fundamental concept of objectives results in greater performance than when people simply attempt to "do their best."

These objectives have a favorable effect on the performance of individuals, groups, organizational units, and entire organizations over durations of up to twenty five years. By providing direction and a benchmark against which progress can be measured, challenging goals enable people to guide and refine their performance. It is well documented in the scholarly and practitioner literature that specific goals can boost motivation and performance by directing people's attention and effort toward specific objectives (Nohria et al. 2008). These motivational mechanisms frequently result in meaningful benefits such as recognition, promotions, and/or increased revenue from a single job (Lunenburg 2011).

By offering self-satisfaction, accomplishing goals frequently raises organizational commitment, which in turn improves organizational citizenship behavior, decreases turnover, and strengthens the association between tough goals and performance.

2. Linkage between efficient budget and financial performance

When established and used appropriately, a budget can provide invaluable information about the organization's direction, resources, and expectations, resulting in improved financial performance (Joseph 2014). In this context, an efficient budget is defined as an integral aspect of management control systems that strives to promote coordination and communication across firm subunits, establish a framework for evaluating performance, and ultimately motivate managers and other staff (Isci et al. 2006).

a) Communication and Coordination Channel:
To achieve best financial performance, communication and cooperation are critical. Budgets are critical for communicating specific sorts of information to ensure that managers in all sectors of the business are fully informed of the plan and policies, as well as the restrictions, to which the organization is required to adhere (Maher et al. 2018). In essence, budget preparation enables the flow of critical information between all levels of the business, hence increasing levels of involvement during the budgeting process. The budgeting procedure will aid in the coordination of business activities (Ueno 2000). Because the budgeting process brings all of the organization's actions together and reconciles them into a single plan, it helps to bond the organization together in pursuit of the company's purpose. Without supervision, managers may make their own decisions (Joshi et al. 2003), believing they are acting in the organization's best interests. Thus, effective budgeting might result in the best financial performance.

b) Motivator:
A well-managed budget establishes a baseline against which management will evaluate their performance. If they consistently meet their targets, they may be driven to pursue a greater target. If budgets are dictated from above and placed on individuals charged with carrying out

the plan, they are unlikely to encourage employees and may even be opposed (Butz 2011). Thus, effective budgeting might result in the best financial performance.

c) Evaluation and Control of Performance:
Budgets serve as a guide to what constitutes acceptable performance. Each budgeting entity's managerial effectiveness is evaluated by comparing actual performance to budgeted expectations (Brahmana et al.). The majority of managers want to understand what is expected of them in order to measure their own performance. Budgets contribute to the provision of that information (Stuart 1970). While managers can be assessed on additional criteria, it is beneficial to have some quantifiable measure of performance. Planned actions can be compared to real ones, concentrating attention on determining the cause of the discrepancies. Managers may be able to uncover inefficiencies such as the purchasing of low-quality materials by studying the reasons behind the disparities. When the causes of inefficiencies are identified, appropriate control measures will be applied (Libby and Lindsay 2012) . Due to the fact that performance evaluation and control are critical components of achieving optimal financial performance, an effective budgeting system might be beneficial.

d) Goal Orientation:
According to the organization's aims and objectives, resources should be distributed to projects and activities. As logical as this may appear, connecting broad corporate objectives to individual projects or activities can be challenging at times (Hong et al. 2015). Numerous general objectives are not operational, making it impossible to determine the impact of specific projects on the organization's overall objectives.

e) Cost awareness:
Cost awareness is critical for optimizing financial performance. While accountants and financial managers are constantly concerned with the financial consequences of their actions and operations, many other managers are not (Draheim 2013). Production supervisors are concerned with output, while marketing managers are concerned with sales. Costs and cost-benefit correlations are frequently overlooked by individuals. However, during budgeting time, all managers responsible for budgeting must convert their plans for projects and activities into costs and benefits. This cost consciousness establishes a common language for communication throughout the organization's diverse functional departments. Thus, effective budgeting might result in the best financial performance.

Conclusion

An efficient budgeting do not guarantee success, but they do greatly assist in achieving optimal financial performance. The budget is a critical tool for translating broad plans into specific, actionable goals and objectives. The expectation is that by adhering to the budgetary guidelines, the identified goals and objectives will be met.
Budgeting is widely used and has long been seen as a critical management tool. Budgeting allows for more control and communication, as well as motivating employees. A budget is a financial plan for managing future operations and results. It can be measured in dollars, units, pounds, and hours. Budgets link the non-financial plans and controls that guide day-to-day management activities to the financial plans required to attain a satisfactory profit and financial

position. Budgeting necessitates the following steps: Capacity to predict & Communication, authority, and responsibility channels that are transparent & accounting information is accurate, reliable, and timely.

The indicators of effective budgeting assist management in focusing their attention on critical issues. Budgeting intensity is one determinant that affects outcome-oriented steering. System quality acts as an input to the budgeting process by facilitating the usage of budgeting instruments. In turn, these factors contribute to management's rationality by enhancing leadership effectiveness. Management accounting's coordination function seeks to enable rational decision-making by integrating the budgeting system with the rest of the organization's subsystems.

Integration of budgeting systems and strategy is a critical CSF (i.e., the strategy link) Budgets are a component of performance measurement since they specify specific objectives with the intent of inspiring desirable behavior. However, if incentives are not properly aligned with budgets, financial slack emerges.

An efficient budget strives to promote coordination and communication across firm subunits, establish a framework for evaluating performance, and ultimately motivate managers and other staff. Budgets are critical for communicating specific sorts of information to ensure that managers in all sectors of the business are fully informed of the plan and policies. If budgets are dictated from above and placed on individuals, they are unlikely to encourage employees and may even be opposed. Cost awareness is critical for optimizing financial performance, but many managers are not aware of it. Many general objectives are not operational, making it impossible to determine the impact of specific projects on the organization's overall objectives. Cost-conscious managers must convert their plans for projects and activities into costs and benefits.

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