

# A Field Study of the Emerging Practice of Beyond Budgeting in Industrial Companies: An Institutional Perspective<sup>†</sup>

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**ABSTRACT** The accounting literature differentiates between key functions of budgeting, such as planning, control, and evaluation, and mostly assumes that firms carry out an annual budgeting exercise. The purpose of this paper is to explore how an institutionalised practice, such as budgeting, changes and to examine the implications of such change for the functions of budgeting. We conduct a field study of five industrial companies that recently either abandoned their annual budgeting system or radically simplified it. Our findings suggest that although new management accounting tools replace the budgeting system, the planning, control, and evaluation functions remain. We observe two approaches for the emerging practice of Beyond Budgeting. In the first approach, firms differentiate between target setting and forecasting. This differentiation appears to be a driver for budget abandonment. In the second approach, target setting and forecasting remain interlinked and many characteristics of traditional annual budgeting remain, albeit in a simplified form.

## 1. Introduction

Budgeting is a central tool for the control of organisations by management. It is also one of the main tasks of firms' accountants (Malmi *et al.*, 2001). Therefore,

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budgeting's role has naturally generated active discussion between academics and practitioners and is one of the most widely studied topics in management accounting (Luft and Shields, 2003). The current, often practice-led, critical budgeting discussion can be vaguely labelled as the *Beyond Budgeting* debate. Beyond Budgeting strives to eliminate traditional budgeting (Wallander, 1999; Hope and Fraser, 2003). The stated shortcomings of budgeting include such claims as that annual budgeting is soon outdated; is time-consuming, expensive, and causes gaming; does not add value; and is based on a supply-oriented idea of production, which means that it lacks a customer orientation. (Bunce *et al.*, 1995)

Management accounting studies reflect this normative criticism of the changing budgeting practice and conclude that some shift exists from annual budgeting practices towards methods of simplified budgeting and rolling forecasts with a more forward-looking emphasis (Sivabalan *et al.*, 2009; Libby and Lindsay, 2010; Østergren and Stensaker, 2011). However, only limited evidence exists of radical developments, or of companies that have gone Beyond Budgeting. Rather, a safe assumption is that most developments are both continuous and incremental, and take place over relatively long periods of time (Hansen *et al.*, 2003). Such conceptions indicate the importance of understanding the contradictory nature of various budgeting functions.

In general, budgeting practices seem to change slowly (Granlund, 2001). In a few exploratory studies, traditional budgeting still appears to retain its strong position, but some evidence exists of emerging developments such as rolling forecasts and balanced scorecard (Ekholm and Wallin, 2000; Libby and Lindsay, 2010). Our interest is in obtaining a comprehensive picture of these emerging practices. We need a better understanding of how these more predictive methods and Beyond Budgeting ideas align with, or possibly replace incrementally, annual budgeting and how the central functions of budgeting are accomplished in companies where long-term investments and sharp market fluctuations create challenges regarding annual budgeting. The basis for our study is five global industrial organisations at the very core of traditional Finnish heavy industry: paper and steel production.

Regarding the selection of interview sites, we sought to find companies in which the traditional budgeting practice was previously highly institutionalised, yet seemed nevertheless to be changing. Finnish research especially examines the paper and pulp industry. For instance, Ekholm and Wallin (2000) classify the Finnish paper and pulp industries' budgeting practices as conservative and Ihantola (1997) describes the stability of traditional budgetary climate in the Finnish paper industry. In fact, in their review of the budgeting practices of Finnish corporations, Ihantola and Merikanto (2005) conclude that while annual budgeting gained widespread acceptance in Finnish traditional heavy industry by the end of the 1950s, such practices were viewed in a critical light from the very beginning.

The traditional textbook definitions usually emphasise the role of budgeting as an operative tool for management control and distinguish it from strategic

planning and forecasting. For example, according to Anthony and Govindarajan (1995, p. 370) 'the operative budget usually covers one year and states the revenues and expenses planned for that year'. Budgeting's characteristics include the following: the commitment to objectives by management, the review and approval by a higher authority, binding and restricting nature of the process, and the periodical variance analysis of the budget. However, new developments in budgeting have extended these budgetary concepts. For example, rolling budgets or rolling forecasts that firms produce on a monthly or quarterly basis illustrate more dynamic and flexible processes in contrast to static traditional budgeting. In rolling forecasts, the forecast is always available for a specified future period, usually between 12 and 18 months, and adds a new month or quarter as the old month or quarter ends. The benefits of the rolling forecast include continuous planning throughout the year, less detailed content, easier updating, focus on the future, and a timely reaction to planning (Hansen, 2010).

A rolling budget is often understood as a synonym for a rolling forecast or continuous budgeting, but more often it is just a revision of an existing budget or a way to re-budget figures (Hansen and Van der Stede, 2004; Libby and Lindsay, 2010). Consequently, the concepts of traditional and annual budgeting might embody the existence of budget criticism and new developments in budgeting, that is, the concepts are used to clarify the ambiguous term of budgeting or to distinguish one perspective from another (see, Ekholm and Wallin, 2000; Hope and Fraser, 2003).

Regardless of the research approach, one central theme in budgeting studies is the interaction between the multiple purposes and goals of the budgeting practices. Sivabalan *et al.* (2009) distinguish ten reasons for budgeting that can be broadly described as relating to planning, control, and evaluation. The authors conclude that the planning and control operational reasons to budget are regarded as equally or more important than the reasons for the evaluation. Importantly, both Hansen and Van der Stede (2004) and Sivabalan *et al.* (2009) discuss the different emphases between the functions of budgeting and incorporate the possibility of rolling forecasts and a continuous planning/budgeting process. Such discussions inherently view budgeting as part of the wider context of management control in which the organisational boundaries of budgeting are fuzzy and in which the functions of the budget can be taken care of with other management accounting tools or control instruments (Flamholtz, 1983; Malmi and Brown, 2008).

In studying budgeting change and the emergence of the Beyond Budgeting practices, we draw from the recent theoretical work on institutional change processes, especially the model of institutional change by Greenwood *et al.* (2002). Moreover, the functions of budgeting that appear in relation to management's control (Flamholtz, 1983) are of interest to us; because, if the importance of budgeting declines and its functions become more limited, we can ask what management control instruments might replace the function formerly fulfilled by budgeting. Thus, our research question is: how does an institutionalised practice,

such as budgeting, change in industrial companies, and what implications does such a change have for the functions of budgeting?

This paper is structured as follows. Section 2 presents the research design. Section 3 presents the theoretical framework of the study. In Section 4, we describe the budgeting practices in our case companies from the perspective of budgetary functions, after which the complexity of the change processes is illustrated through a model of institutional stages of change in Section 5. Section 6 presents some concluding remarks.

## 2. Research Design

We approach our research question through a field study of five industrial companies. A field study is a particularly suitable method for an exploratory study when investigating emerging phenomena (see, e.g. Malmi and Ikäheimo, 2003; Lillis and Mundy, 2005). Case and field studies normally avoid excessively simplistic research designs, but rather leave room for diversity and complexity to increase the understanding of the research issue (Eriksson and Kovalainen, 2008).

We chose a field study method because, in addition to budgeting change, we are also interested more widely in the institutional elements that influence such changes. The idea of this extensive case study is to collect similar empirical data for each case (Eriksson and Kovalainen, 2008). We are looking for data on how our case companies carry out the traditional functions of budgeting, and what new management accounting methods they introduce in the course of budgeting change. In fact, our study reflects the perspectives of both emic and etic modes (Kakkuri-Knuuttila *et al.*, 2008). We strictly follow the emic account in our study; that is, we are open to the accounts of our interviewees about the new methods related to budgeting without the strict *ex ante* definitions of budgeting or Beyond Budgeting. Nevertheless, we must still revert to the etic mode in our study to be able to reflect on our findings on earlier management accounting research.

Originally, we were attracted to the five case companies because of the literature and the detected tension between the capital intensity and sharp market fluctuations in the industrial field. In fact, Ekholm and Wallin (2000) find that while traditional budgeting still has a role as an instrument for maintaining internal effectiveness, external effectiveness must be achieved by supplemental instruments. We take as a base position that multinational industrial corporations cannot operate effectively without planning and coordination functions, and are interested in empirically observing how such functions are fulfilled when the role of budgeting diminishes.

### 2.1. Data Collection

Our data comprise 31 interviews with controllers during three separate but relatively short time periods (see the online Appendix). The first part of the data

consists of seven interviews mainly at the factory/production-site level. We collected these interviews in 2007 and 2008. The second part of the interview data consists of 16 interviews with controllers from site, business unit, divisional, and group levels during 2009 and 2010. The third part of the interview data consists of eight interviews during 2011. The interviews are semi-structured to guide the discussion, and we base the themes on the relevant literature and the pre-understanding of the new developments in budgeting (see the online Appendix). The interviewees are free to raise important issues for discussion. The recorded interviews last from half an hour to nearly two hours each and are transcribed. All in all, our aim is to produce an authentic account of the emergence of new budgeting practices in the light of the interview data. The interviewees are mainly from different organisational levels of the controlling function. We also have some secondary data sources such as e-mails from interviewees, organisation charts, and descriptions of organisational functions.

### **3. Theoretical Framework**

In order to investigate the budgeting practices emerging almost simultaneously in several industrial companies, we draw on new institutional theory, especially the concepts of organisational field (DiMaggio and Powell, 1983) and stages of institutional change (Greenwood *et al.*, 2002). Regarding organisational fields, these are defined as ‘sets of organizations that, in the aggregate, constitute an area of institutional life’ (DiMaggio and Powell, 1983, pp. 148–149) and ‘a community of organizations that partakes of a common meaning system and whose participants interact more frequently and fatefully with one another than with actors outside of the field’ (Scott, 2008, p. 86). Importantly, the concept of field is linked to the idea of organisational change. Although the early institutional literature has undeniably focused on isomorphism and stability, observers of the social world know that change takes place even in highly institutionalised environments. Thus, organisational fields are seen as dynamic and capable of moving towards something other than isomorphism. Such movements mean that modern institutional theory no longer portrays institutional settings as highly stable, permanent, and conforming (Greenwood *et al.*, 2008).

Greenwood *et al.* (2002) propose a staged model of change, where precipitating *jolts* or events (stage I) originating from the institutional field lead to *deinstitutionalisation* (stage II) and *pre-institutionalisation* (stage III), that is, the dissolving of existing structures and the emergence of innovations. However, full deinstitutionalisation rarely occurs, and the dissipation of the practice can occur through several mechanisms such as assimilation, dilution, disembedding, competition, and erasure (Dacin and Dacin, 2008).

A key phase then concerns *theorisation* (stage IV) that involves organisational processes where the organisation seeks legitimacy and demarcations between the new and the old structures. Successful theorisation is followed by *diffusion* (stage V), but also possible *reinstitutionalisation* (stage VI) of old organisational

designs. Nevertheless, full institutionalisation is based on the historical continuity of the practice, allowing it to be transmitted across generations or organisational members (Tolbert and Zucker, 1996).

Given the highly institutionalised nature of budgets, Flamholtz (1983) finds that the functions of budgets go beyond the rationalistic planning and control cycle. Instead, he proposes that budgets should be seen in the wider context of management control in which they serve various purposes depending on how the rest of the control is organised. Adopting such a view on annual budgeting allows for its interpretation as a strongly institutionalised and taken-for-granted practice.

In conclusion, little attention has been given to understanding why institutionalised practices change. If budgeting is a taken-for-granted practice in organisations, then interesting questions are to delineate what is the process through which the emerging archetypes are introduced, and what are the mechanisms through which the prevailing practices are delegitimised and new practices legitimised.

#### **4. Budgeting Practices in the Case Companies**

The basis for the empirical part of our study is the five global industrial organisations at the very traditional core of the heavy industry in Finland: paper and steel production. To ensure the confidentiality of the data collected, the study uses a letter for the name of each case company. All the companies entered intensifying global competition and underwent various structural changes such as mergers, acquisitions, divestments, spin-offs, and changes in ownership structure during the past 15 years. The year 2009 seems to have been exceptional for all the case companies. There were significant drops in demand and at the same time the companies were struggling with excess capacity. There were also difficulties in forecasting demand; consequently business predictability was lower than usual. Under such circumstances, we expect to find situations in which new budgetary techniques are more likely to challenge the existing static annual budgeting systems.

##### *4.1. Overview of the Field Sites*

Three of the five companies (A, B, and C) operate in the paper industry and have different sizes and forms. Companies A and B are global leaders in the paper industry. Both have a long history in the Finnish industry dating back to the nineteenth century. Company A operates globally in the packaging, paper, and wood products industry. It has about 26,000 employees and 85 production units worldwide. The company's sales in 2010 exceeded €10 billion. The core business areas of Company B are paper, engineered materials, and energy and pulp. The company has production units in 16 countries and employs approximately 24,500 people worldwide. The company's sales in 2010 exceeded €10 billion.

Company C is a subsidiary of an international forest industry group based in Finland and therefore a smaller case unit, but the company is one of Europe's biggest pulp producers. It has about 900 employees. The company's five production units are located in Finland and Russia. Its total, sales in 2010 reached € 1.4 billion.

The last two companies (D and E) represent the other major part of the Finnish heavy industry, namely the steel industry. Company D manufactures and supplies hot and cold rolled stainless steel sheets and plates and strips that are used in a variety of industries. Company D operates in 30 countries and has production sites in Finland, Sweden, the UK, and the USA. The company employs about 8000 people and the sales in 2010 exceeded €4 billion. The operations of Company E are in the construction, engineering, and steel businesses. It has production sites in 12 countries and employs over 11,000 people. Company E's sales in 2010 reached about € 2.5 billion.

#### *4.2. Fragmented Nature of Budgeting Practices*

This section reviews the change in budgeting for each case company. In each description, we first describe the change by illustrating the duration of the change process. Then we explain the change and new practices introduced by first presenting the fragmentation of budgeting into various management accounting tools and then explaining what functions of traditional budgeting they serve.

##### *4.2.1. Company A – paper industry*

From the interviews with Company A in 2007 and 2011, we witnessed a relatively fast transition from traditional annual budgeting to a collection of tools for management control. In Company A, the importance of rolling forecasting had clearly increased and overtaken annual budgets regarding the function of planning. First, the company started to utilise key forecasting assumptions (future sales volumes and prices, energy prices, raw-material prices, etc.) that reflected the recent fluctuations in the markets and gave greater realism and transparency to the changes in the forecast. Forecasting assumptions were delivered regularly by the expert functions, which increased the growing ownership and responsibility of their special area in the forecasting. The sales forecast in particular gave major indications of demand and the prices to be charged in the management of the production capacity and in the setting of selling prices. Second, the enhanced forecasting was also linked to a rolling action plan that contained information about the forthcoming and already included actions in forecasting. This plan was an important part of the coordination of the company's resources.

In Company A, target setting was separated into its own process with a link to strategy and the rolling forecast. The main focus of the target setting was on control, especially variance analysis, and on evaluation as a basis for bonus determination. One version of the rolling forecast was used as the basis for the target-setting process. The idea of stretched targets was to give the option to follow the



changes in the business environment and revise the targets in the middle of the year. The following comment illustrates the different natures and decoupling of target setting and forecasts:

It is important to distinguish between target setting and rolling forecasts. This means that forecasts deal with where we will be realistically, and there has to be a gap between the forecast and the target, because the target is the figure to which bonuses are tied. (Group controller, Company A, 2.10.2009)

Nonetheless, some remnants of traditional budgeting persisted. First, fixed-cost budgeting was an important method for cost control and cost reduction in cost centres both in support functions and at the plant level, where it was partly used for evaluation (incentive system) purposes. Second, illustrating the taken-for-granted nature of budgeting, sometimes the first version of the rolling forecast for the following year was fixed as a frozen forecast and subsequently called a budget for variance analysis.

#### *4.2.2. Company B – paper industry*

In Company B, the current budgeting practices started in 2002. With the introduction of rolling forecasts, the old annual budgeting process became concerned with only the fixed or operative costs, while target setting was managed by a separate process. The idea of rolling forecasts was to regularly reach a realistic consensus between the expert functions with regard to the prospects for the next 12 months by starting with sales prices and volumes. The controller received forecasting assumptions for all key forecasting areas delivered by the central expert organisations like sales, purchasing, or logistics. Well-organised delivery of forecasting assumptions seems to be quite a recent improvement in the planning process. Previously, forecasts were often manipulated. Thus, if the forecasted profit level was considered too low, the assumptions in the background of the forecasts were revised. Now, the calculation is made according to the most recent expert information without speculation.

If our forecasted profit level seemed to end up too low, then either the prices or the volumes would be slightly increased, or estimated costs would be cut. Thus we had quite a lot of so-called profit-oriented forecasting last year [...] Today we have gone purely to a model where our sales function defines the prices and volumes that we can sell, and then we have a purchasing function which knows the raw-material prices and then we just calculate the forecast profit without any speculation. In that sense it is an expert approach ... (Controller, Company B, 1.10.2009)

In Company B, we could observe some characteristics that illustrated the nature of the independent target-setting process. First, target setting seemed to be clearly



decoupled from planning, but, in turn, tightly coupled with strategy. Target setting was not understood as a tool, but rather as a top-down commitment process with discussions at several organisational levels. Target setting appeared to be a central method for control and evaluation in the company and was applied to performance analysis and incentive provision. Second, the company used benchmarking to obtain relative performance targets, that is, to compare the performance of the company's own plants with the performance of other plants either within the same industry or in another. The remnants of traditional budgeting, the frozen forecast and fixed-cost budget, still had some relevance in serving the functions of control and evaluation.

#### *4.2.3. Company C – paper industry*

In Company C, the nature of budgeting started to change in 2002. There was a shift from traditional build-up budgeting to a lighter process, the annual plan. Rolling forecasting started soon after that. The starting point for the initial change was the simplification of the traditional annual budgeting. This simplification meant, first, a shift from a build-up to a top-down method in which the focus was more on strategy-based targets and the control function and, second, the deliberate replacement of the term budgeting with annual plan. The idea of this rhetoric was to indicate the changing nature of the budgeting. On the face of it, the process was lighter and simpler than traditional budgeting. An interviewee in Company C highlighted the following difference:

We don't want to talk about budgeting, we talk about annual plan. When we had this traditional budgeting, which started from the bottom of the organization to the top and there we had economic targets, which were then again cascaded down ... but this annual planning then, it starts from the revised strategy followed by annual targets and is then cascaded down in the organization, so it goes top-down, so there is not so much the same in it. (Business controller, Company C, 15.12.2009)

However, on closer examination, we found elements of the traditional budgeting process. The formal process of annual planning started each year in September with the review of the strategy, targets, and action plans. The information was gathered according to the company's instructions into a master budget booklet. In performance evaluation, the annual plan was an important reference point. Rewards were linked to the personally discussed goals, which were based on the annual plan. One version of the rolling forecast, a frozen forecast, was the basis for the annual plan. The annual plan, in turn, was closely linked with the balanced scorecard; the main function of which was evaluation, that is, to implement the strategy and targets of the annual plan and to monitor the commitment to them. Internal benchmarking was an evaluation tool for comparison between plants.

Rolling forecasts became an important planning tool for giving a fresh and realistic perspective on the changes in the business and a control tool for variance analysis. The forecasting assumptions (exchange rates, chemicals prices, raw-material prices, energy prices, etc.) were obtained centrally from the parent company.

#### *4.2.4. Company D – steel industry*

In Company D, the annual budgeting started to change at the end of the 1990s when budgeting was no longer a corporate requirement. The speed of the market fluctuations was an important starting point for enhanced planning and more predictive methods in the company. Company D's business environment seemed to be especially volatile; and, as a consequence, sales became a critical input. The determination of selling prices was based on market information; for example, changes in demand and prices, which in turn had implications for corporate profitability, and the production volumes allocated at each plant.

At the plants, cost budgeting was done in the spirit of traditional budgeting. Thus, the evaluation function of budgeting legitimised the cost budget, which was seen as important for incentive compensation especially at the plants. The group controller emphasised the control power of budgeting compared to forecasting; budgeting was not merely the generation of figures but also a method to increase cost consciousness and coordinate resources in the organisation.

Cost budgeting and sufficient control and review of the costs are absolutely useful. From my point of view it should not be totally abandoned [...] To live in a purely rolling world without any kind of target-orientation doesn't work. (Group controller, Company D, 27.10.2009)

In spite of cost budgeting, there was a separate target-setting process decoupled from planning, the guidelines of which were outlined according to the value-based management (VBM) philosophy. The process gave the standards for controlling business in which the strategy was divided over value drivers (e.g. activity or other factor of the business process that creates value for the customer) and further on targets and measures to be evaluated. The targets were delegated to the business areas, departments, teams, and even individuals to be reported and followed up on in the balanced scorecard. According to the corporate controller, the VBM process partly replaced the traditional budgeting process as a target-setting tool, and so it appeared to serve both the functions of control and evaluation.

#### *4.2.5. Company E – steel industry*

In Company E, budgeting was executed in a fairly traditional manner without any major developments. Regarding the functions of budgeting, the present build-up method of budgeting seemed to serve all three functions of budgeting: planning, control, and evaluation. However, budgeting could not reflect the fluctuation in the business and was therefore unable to successfully serve the planning function.

Hence, forecasts were gradually taking a more significant role in planning. In Company E, rolling forecasts were made monthly for the next 12 months with the aim of a fairly realistic view of the future. These forecasts served the planning function of traditional budgeting and also provided important information to external parties. One interviewee stated that, as a listed company, they had to provide investors with information about their future prospects.

We could observe a hint of rhetoric, as the use of the term budgeting was forbidden and replaced by annual plan. This replacement indicated budgeting's diminishing role to a once-a-year target, an overall picture and efficiency tool, that seemed to conflict with its influential status in the bonus scheme. The legitimacy of the annual plan was earned by the target-setting function.

Often the budget is already out of date when it is completed, so its role in planning is diminishing. The current practice is changing to, not quite to a strategic tool, but rather to a target plan. (Business controller, Company E, 15.12.2009)

The annual plan process started in June with strategic three-year planning and the big picture of the company's goal. The process included to some extent budget-type negotiations, commitment to targets, and approval by the company's board of directors. The annual plan and the ability to reach given targets were continuously assessed through the rolling forecast and possible gap-to-target variances that generated remedial actions.

The interviewees in Company E emphasised the cultural problems of budgeting. First, in the annual plan the diligence that is characteristic of engineers caused endless iterations and prolonged the process of budgeting. Second, there were strong traditions of budgeting at the plants; therefore budgeting was profoundly ingrained and had strong managerial support. Third, there was no proper forecasting culture in the company, which meant that the factors affecting profit were not sufficiently well known.

#### *4.3. Integrated Package of Forward-Looking Methods*

During the interviews of our case companies, we observed a change in everyday budgeting practices and change in the common shared meaning of budgeting in the speech of the people. The traditional master budget as a formal document and long-standing process was fragmented as a collection of various tools such as rolling forecasts, fixed-cost budgeting, target setting, annual plans, benchmarking, balanced scorecards, and VBM. However, in this newly formulated budgeting practice we could identify the key functions of budgeting; including planning, control, and evaluation (Sivabalan *et al.*, 2009). Figure 1 summarises these findings.

In interpreting Figure 1, we draw on Malmi and Brown (2008) who believe that by examining the control system as a package and considering the various

Planning	Control	Evaluation	Company
		Balanced Scorecard	C D
		VBM	D
		Benchmarking	B C
	Cost budgeting		A B D
	Target setting		A B D
Annual plan			C E
Rolling forecast			A B C D E

**Figure 1.** Functions of various budget-related methods for the case companies.

elements in it and how they are used, we can find a clue about how the different systems (here the parts of a system) substitute and complement each other in practice. Even though all of our case companies abandoned budgeting in its traditional form as a uniform and general process of management control, the traditional functions of budgeting were still performed using various methods. Figure 1 illustrates the fragmented nature of budgeting practices serving the different broad functions of planning, control, and evaluation (cf. Sivabalan *et al.*, 2009). One interviewee emphasised the incremental nature of the change and described the emergence of the accounting tools that replaced the former functions of traditional budgeting.

They have been integrated and it is . . . a single process. We have both long and short term processes and also analysis and action plans, so it is a fairly well integrated package. It hasn't been developed by chance, but it has been composed over the years. (Business controller, Company A, 6.6.2011)

Moreover, contrary to earlier assumptions (Hansen *et al.*, 2003), we do not consider the planning and control techniques as a spectrum where each company selects either a planning or control focus. Rather, we see different techniques

as a parallel and complementary package in which planning, control, and evaluation are of equal relevance to the companies.

#### *4.4. Decoupling Between Budgetary Planning and Target Setting*

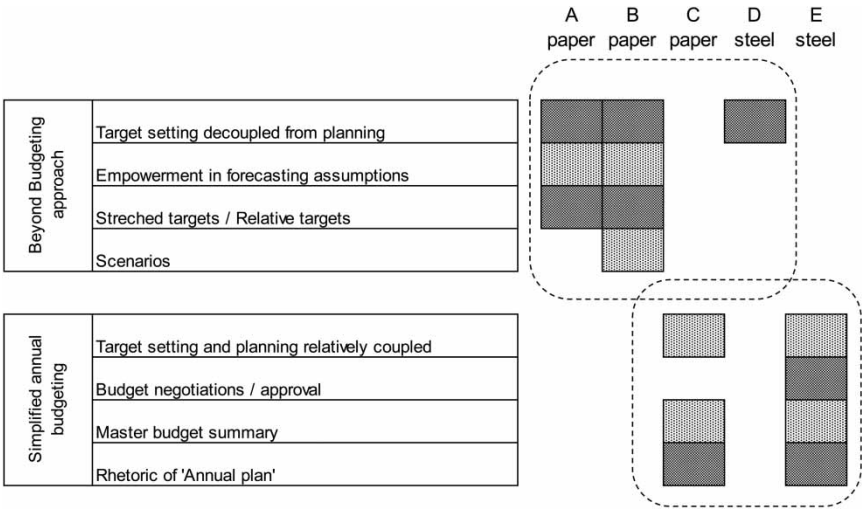
Our study indicates that from the perspective of budgetary methods, various tools are intensely integrated. However, at the functional level, decoupling between the budgetary methods becomes decisive for the erosion of traditional budgeting and could explain the two budgeting approaches found in our case companies.

In Companies A, B, and D, target setting that performed the functions of control and evaluation was decoupled from the rolling forecasts (planning). The role of rolling forecasts was to strive for realism, whereas the role of target setting based on strategy was to clearly challenge. The companies' continuous analysis of the gap between the forecast and the target generated actions to be taken. Frow *et al.* (2010) discuss such continuous budgeting and find analysing budget gaps as a boundary system in which budget-responsible managers are subjected to the competing demands of planning and control. Relating to the budget's evaluation function, adherence to a factory-level cost budget is in fact the only link between the former budgets and the rewards we observed in these three companies. This separation partly supports the approach to the main processes (target setting, planning, and resource allocation) in the Beyond Budgeting literature (Østergren and Stensaker, 2011). Therefore, we conclude that the approach in these companies is a Beyond Budgeting approach.

In Companies C and E, planning and target setting remained relatively coupled. In fact, the method of an annual plan appeared to serve more or less all the functions of budgeting and had several elements of traditional budgeting such as a master budget-type summary, a process for negotiations, and an official approval. Moreover, rewards were still partly tied to the fixed budgetary targets in the annual plan. Based on these findings we conclude that the approach is simplified annual budgeting. Figure 2 illustrates the two approaches to budgeting in the case companies.

The distinguishing feature between these two approaches is the decoupling of the key functions of budgeting. One critical basis for decoupling is the recent stronger pursuit of realism in the planning and empowerment of expert functions (Companies A and B). Another feature is the impetus for creating a common shared understanding of the core functions of various methods.

The interviewees use the concept of profit-oriented forecasting to refer to the characteristics of the traditional budgetary process that remained in the rolling-forecast process. According to this traditional view, budgetary targets are challenging, and they are negotiated between top and middle managers in order to establish a target to which all the parties can be committed. Often, if the target profit seems unrealistic, the managers adjust the budgetary assumptions. This adjustment is in contrast to sales-oriented forecasting that emphasises the forecast nature of the realism and profit figures. Here, the managers receive the forecasting assumptions



**Figure 2.** The two approaches to budgeting.

**Table 1.** General characteristics of profit and sales orientation in rolling forecasting.

Profit-oriented forecasting	Sales-oriented forecasting
Target-oriented: It is important to have challenging budgetary targets	Realistic orientation: it is important the forecasts are accurate
Profit simulations before the final target	Expert forecasting assumptions and straight calculation of profit
Iterations and negotiations	Consensus forecast
Emphasis on profit target	Emphasis on costs and volumes
Planning and target-setting processes more integrated	Target-setting process decoupled from planning
Realisation of target: forecasting drives actions (forecasting serves control function)	Realisation of target: gap between forecast and target setting is the impulse for action planning (forecasting serves the planning function)

from an expert third party and cannot easily adjust them. Instead, they invest most of their effort in maximising the accuracy of the sales forecast. Table 1 presents our summary of the themes raised by the interviewees in a juxtaposed manner.

**5. How Does Budgeting Change?**

How do deeply embedded organisational practices such as an annual budgeting change? We draw on the model proposed by Greenwood *et al.* (2002) to highlight the complexity of the change processes and to explain the underlying mechanisms through which the change occurs.

### *5.1. Precipitating Jolts*

In our study, the role of the organisational field is central to the stage of precipitating jolts. For example, an influential field comprises new emerging competitors and raw-material suppliers. Most interviewees at the business and group level mentioned that the volatility of the business had increased. For instance, in the paper industry, cyclical variations had almost disappeared, which had the effect of undermining predictability and making budget targets more difficult to set. These problems stemmed partly from the increased globalisation and the emergence of new players in the markets. Consequently, these jolts generated functional pressures, that is, the utility of the static annual budgeting gradually eroded and emerging pressures for more proactive planning became obvious.

Business cycles meant that we had a seven-year upward trend and then a seven-year downward trend. It made forecasting slightly easier. But new players have emerged, South Americans, lots of Asians, which smoothenes the cycles, the fluctuations have disappeared. (Group controller, Company A, 2.10.2009)

Another consequence of volatility was the turbulence in big cost factors. Both in the steel and paper industries, the variation in raw-material prices seemed to cause difficult problems in profit forecasting. While the world today seemed to be much more volatile and dynamic, the companies needed timely reaction to a constantly changing environment. Even though they did not directly mention the financial crisis of 2009, its implications appeared to be evident. According to one interviewee, the market fluctuations now seemed larger and more dramatic than before, which the interviewee expected would have major implications for the role of budgeting in the near future.

### *5.2. Deinstitutionalisation*

During the interviews, we could see that various functional contradictions between planning, control, and evaluation manifested themselves; for instance, the tension between realistic forecasts versus challenging targets was causing the erosion of the budget's legitimacy. Therefore, the key mechanism for the occurrence of deinstitutionalisation is disembedding, that is, the decoupling of core elements (functions) of traditional budgeting from each other in the sense that the uniform traditional process ceased to exist (Dacin and Dacin, 2008). Actually, the planning function of budgeting is where the legitimacy of annual budgeting first started to decline. The following quotation clarifies this decline:

The role of it [annual budgeting] has really diminished and its functions have changed. The budget is commonly used as the basis of annual targets, but if we look at the last few years, we can see that one went



right up and the other right down, and our budget couldn't illustrate the world which we were actually living in. In that sense the rolling forecasting is the relevant tool. (Business controller, Company E, 15.12.2009)

The control and evaluation functions of budgeting in the form of a separate target-setting process erode more slowly. The target-setting process seems to be partly in the process of being developed in some companies:

The role of budgeting for the target setting process has decreased [...] and disappeared. The target setting process is now in a kind of development phase, we update [the targets] and follow the actions, but they need to be integrated. (Business controller, Company A, 2.10.2009)

### *5.3. Pre-institutionalisation*

The stage of pre-institutionalisation involves various interactions with the organisational field, such as discussions about the importance of forecasting techniques and forward-looking management accounting practices. Importantly, several actors such as CEOs and consultants begin to get mobilised around such developments. For example, in Company A the significance of forward-looking emphases was constantly highlighted by management and the CEO. The controllers in the company felt that the interests of the new CEO were decisively guiding their forecasting and it also seemed to guide the focus of the controller's function in that direction:

... our new CEO [...] has put pressure on us to look forward, so it is, I do believe it is everywhere, the same trend. (Business controller, Company A, 26.10.2009)

Abandoning the traditional annual budget requires training and consultancy – both to familiarise controllers with the new method and to introduce a philosophy of doing things differently. One mill controller commented on the use of consultants and the on-going process of training controllers as follows:

There was a consulting company involved and we then discussed the vision, what the controller's role will be in future. It also included quite massive training where we had actual business cases and analysed them ... (Mill controller, Company A, 17.11.2009)

Importantly, during the interviews we noted that turnover was very common among the group-level controllers. Four of our interviewees left their jobs during our research process and moved to another company. This turnover might explain why the controllers felt that new budgeting methods were not

business-sensitive issues, but could be openly discussed with colleagues in other industrial companies. Relating to this, one interviewee commented:

And the way we get to know about new solutions, is actually the fact that there are a quite small group of us, you know your colleagues in other companies and hear from them. [...] These are not such sensitive business issues, so we have discussed them with colleagues in other businesses. (Group controller, Company A, 2.10.2009)

#### *5.4. Theorisation*

Theorisation is the key stage in institutional change (Tolbert and Zucker, 1996; Greenwood *et al.*, 2002). It involves two major tasks: specification of a certain organisational failing, for example, finding plausible explanations for why annual budgeting does not work and justification in which the new practice is framed as a solution to a specified problem. Regarding specification, the alleged shortcomings of budgeting in the interview data were numerous. Many controllers expressed their dissatisfaction with budgeting. The most common problem was the resource-intensive and time-consuming nature of traditional annual budgeting. In addition, the speed with which budgeting became outdated was criticised. The main criticism was levelled at the planning function in the budgeting:

It was a heavy process, which was probably one reason why we started to change it [budgeting], and then its practical applicability was very small, so these are the two reasons. And then recently the key components of profit and loss have been changing so fast in this business that we must have a system where we can take account of everything ... (Group controller, Company A, 2.10.2009)

One reason why we identify no elements of theorisation concerning the functions of control and evaluation might originate from the incomplete process of deinstitutionalisation. Somewhat contrary to our initial expectations, one evaluation-related shortcoming of budgeting mentioned in the accounting literature, namely budget gaming, we deem to not be problematic. However, the institutional remnant, cost budgeting, was energetically justified by some controllers. We get the impression that in the course of the fragmentation the importance of fixed-cost budgeting was clearly questioned and therefore re-theorised.

#### *5.5. Diffusion and Reinstitutionalisation*

Across all our research sites the interviewees at the business unit or group level were inclined to avoid the concept of budgeting (except cost budgeting). At the

factory level, especially in Company A, the change in budgeting was so recent that the expressions related to budgeting seemed not to be so firmly established. The difficulty is in determining how much of this phenomenon was originally normative. But, a non-budgeting atmosphere appeared to prevail in the companies. In some companies the adaptation to new budgeting practices seemed to be quite fresh and occurred at a very conscious level. One controller expressed this as follows: ‘... we try always to remember to state that we are establishing targets – we are not budgeting’ (Mill controller, Company A 29.9.2009). Nevertheless, the following quotation indicates that some social consensus still prevailed about the value of the new structure in Company A, which probably means a sort of success at the theorisation stage:

We have got rid of budgeting and ... I can’t express it better where the idea has originated but ... [...] ... then there must be some (rational) basis to it.  
(Business controller, Company A, 26.10.2009)

Such comments embody increasing objectification, that is, social consensus about the new organisational design and about its pragmatic value (Tolbert and Zucker, 1996).

## 6. Concluding Remarks

Recent research shows evidence of some developments in budgeting practices (Ekholm and Wallin, 2000; Hansen *et al.*, 2003; Hansen and Van der Stede, 2004; Libby and Lindsay, 2010). However, we still feel that research lacks a comprehensive picture of these emerging practices. Furthermore, if the importance of annual budgeting declines and its functions become more restricted, then we can ask what management control instruments might replace budgeting. Therefore, our research question is: how does an institutionalised practice, such as budgeting, change in industrial companies; and what implications does such a change have for the functions of budgeting?

We conduct an exploratory field study within five global industrial companies in order to investigate their changes in budgetary practices. Our interpretation of the findings draws on the model of institutional change by Greenwood *et al.* (2002). This paper suggests that while annual budgeting has not been totally abandoned by the case companies, the different and often contradictory planning, control, and evaluation functions of budgeting (Sivabalan *et al.*, 2009) might deinstitutionalise in different phases. We find that the critical budgeting discussion (Ekholm and Wallin, 2000) is important in the theorisation stage in which the moral legitimacy for the new budgeting methods is established. Further, relating to diffusion, we find that the decoupling of target setting and planning is a decisive element in the institutionalisation process.

Relating to budgeting approaches, we identify two trends in our case companies. In the first approach (Beyond Budgeting approach), the decoupling of

target setting and forecasting is the key issue. But, in the other practice (simplified annual budgeting), the planning and target setting remain relatively coupled and retain several characteristics of traditional budgeting. Regarding the heavy industrial characteristics of our case companies, the study shows how some remnants of annual budgeting might have important roles in the institutionalisation process. For instance, fixed-cost budgeting remains an important method for cost control and cost reduction in the Beyond Budgeting approach and thus supports the decoupling of planning and target setting. This enhancement might account for the seemingly fragmented nature of budgeting practices in the case companies.

Our study extends Østergren and Stensaker (2011) by illustrating how companies move towards Beyond Budgeting practices gradually. We find that abandonment of annual budgeting practices has a relation with the functions that budgeting serves in companies (Sivabalan *et al.*, 2009). In fact, we find that the separation of target setting from planning is critical to eroding the legitimacy of traditional budgeting. Furthermore, our study conceptualises how management accounting tools can replace and complement each other as a part of the organisation's management control system (Malmi and Brown, 2008). Relating to this, we find that in an incremental move towards Beyond Budgeting, various management accounting tools replace the functions that budgeting serves, not budgeting in its totality.

Finally, we find that the interrelation of these two institutions, budgeting and the management accounting function, might reinforce each other as regards legitimacy. The stronger role of the controller can reduce the role of traditional budgeting, because we can see that the controllers have taken over some tasks of traditional budgeting. However, we are left with the feeling that the interrelation between simplified budgeting, emerging Beyond Budgeting practices, and the increasing business orientation of the controller's role might warrant more research.

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