



# REFLECTIVE PRACTICE

## An endless debate: the sense and nonsense of budgeting

Sense and  
nonsense of  
budgeting

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569

Received March 2008  
Accepted April 2008

### Abstract

**Purpose** – This article aims to summarize several studies about how businesses currently practice budgeting in Western and Central Europe. While analyzing these studies in the larger context of the ongoing debate about budgeting's importance, it provides conceptual linkages between them and additional insights into their findings.

**Design/methodology/approach** – The reported studies employ survey research, sometimes with panels of self-selected interviewees within a single country and sometimes with samples of SMEs across multiple countries.

**Findings** – Recent survey results continue to show managers complaining about the wastefulness of preparing budgets, while steadfastly believing they are indispensable. Among others, Horváth and Partners accordingly advocate “advanced budgeting” concepts to modernize both planning and budgeting processes. CFO-panel participants generally uphold the advocates’ position except in the crucial area of available IT-support. However, as explained next, connecting operational and strategic planning is primarily a conceptual rather than a hard- or software problem. In the European automobile suppliers’ industry, controlling services therefore generally still rely on a small set of well-understood standard tools.

**Practical implications** – Firms not using these standard tools in their operational controlling risk falling behind the competition. In order to close the gap between the perceived importance of and satisfaction with more complex instruments, however, several tools require improvement or simplification as well as conceptual clarity about how to employ them.

**Originality/value** – This article presents results from diverse studies on budgeting as currently practiced, reform concepts, and obstacles to their implementation. In doing so, it discusses how they relate to one another and what their significance is for both theory and practice.

**Keywords** Budgets, Balanced scorecard, Control systems, Performance management, Shareholder value analysis

**Paper type** General review

### 1. Introduction

Recent results from a survey among controllers in small- and medium-sized enterprises (SMEs) with regard to the quality and costs of their budgeting illustrate nicely the Janus-like view managers have of this financial controlling instrument. On the one hand, they complain about the large amounts of time and money consumed relative to the modest utility gained from preparing budgets. On the other hand, most managers do not believe they can make do without them (Kuhn and Pick, 2006)!

In answering a question about the resources budgeting consumes, 10 per cent of the surveyed firms reported needing more than 20 man-months to complete this task. Only 39 per cent of the businesses said they needed fewer than three man-months.



Furthermore, the amount of detail involved in budget planning is very high. Over 50 per cent of the enterprises budget at least 50 cost centers, while 25 per cent base their budgets on more than 100 cost centers. The same is true for the number of general ledger accounts taken into consideration. Researchers therefore wonder whether such highly detailed budgeting genuinely is necessary and efficient.

Also worthy of discussion is the fact that only 36 per cent of the respondents really believe in their budget. A total of 57 per cent of them assess the crunched numbers generated from all that work as moderately realistic at best. Comparison of actual results with forecasts shows further that this self-assessment markedly overestimates budget quality. After only three months, events have overtaken more than half of all budgets. Relative to the planning period, only about 6 per cent of the budgets examined proved to be reasonably accurate. In addition, linking the budget numbers to benchmarks in the form of personal performance contracts hardly improves budget accuracy. Apparently, traditional, static budgets no longer constitute an adequate basis for modern operational controlling.

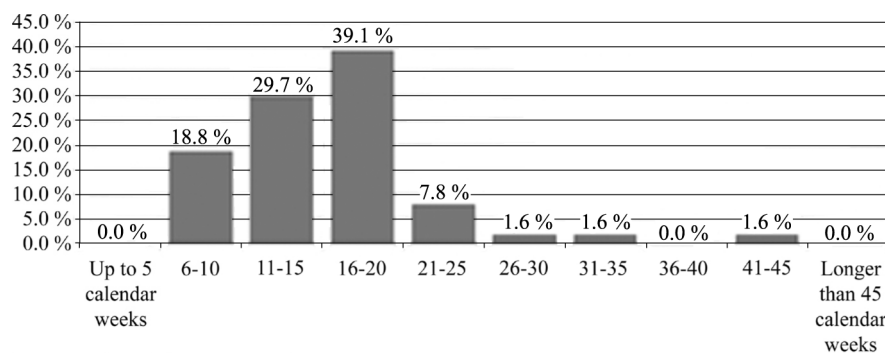
It therefore is all the more surprising that five of six surveyed controllers cannot imagine working without budgets (Obermöller, 2006)! Among others, Horváth and Partners want to familiarize these controllers with the concept of “advanced budgeting” and contemporary instruments for implementing it. They believe their techniques and tools can improve both planning and budgeting processes (Leyk and Kopp, 2004; Leyk and Kappes, 2007).

## 2. Budget planning challenges

Empirical results from a survey of the Horváth & Partners CFO-panel underscore the above critique of classical planning as well as the efficiency and effectiveness of time-honored budgeting methods (Leyk *et al.*, 2006). In 2006, the panel comprised a network of top managers and experts from about 170 larger Austrian, German, and Swiss firms. Panel members share information about best practices and benchmarks in the areas of controlling, finance, and accounting. Results from periodic surveys stimulate discourse among panel members, which leads to recognition of differences and trends as well as the identification of innovations in actual practice. By conducting the survey at least once annually, Horváth & Partners keep the comprehensive database up-to-date. The following presentation summarizes the most recent survey's results, but sets several different accents in their interpretation.

Horváth & Partners' 2006 survey of larger firms yielded results broadly comparable to the ones obtained in the aforementioned survey of SMEs. As shown in Figure 1, budget preparation in bigger companies is a long process. More than half the enterprises represented on the panel need between four and six months for their operational planning and budgeting. Indeed, several firms said they required more than 31 calendar weeks for these processes! Taken together, results from the two surveys suggest that traditional planning and budgeting indeed have evolved into costly, time-consuming processes, offering little opportunity to react quickly and flexibly to changes in a company's environment. Accordingly, panel members find the available time and resources insufficient to control their operations optimally.

Not only are plans and budgets no longer appropriate for the conditions currently prevailing at the time of their execution, often enough they already are obsolete before their approval. This obsolescence arises from long duration of the bargaining and



Source: Adapted from Leyk *et al.* (2006)

Figure 1.  
Length of the annual  
planning and budgeting  
process

negotiations typically involved in planning and budgeting. In larger enterprises, the high degree of detail in budget planning also is an important influence. Decomposing the overall budget problem down to the lowest hierarchical level requisite for detailed analysis consumes large quantities of human and monetary resources. Moreover, wasteful resource consumption occurs every time negotiating partners loop through the planning cycle until they finally approve the annual operating budget. Large firms usually commit 75 per cent to 95 per cent of their total controlling capacity to operational planning during the time they are engaged in budget preparation (Kopp and Leyk, 2004). Unfortunately, top management seldom considers the high cost involved relative to the meager benefit derived from such detailed instruments. It then is no wonder that cost, product, and strategic controlling often get little attention in the process.

Impulses for change issuing from the panel include concepts ranging along a scale between “better budgeting” and “beyond budgeting.” The former involves incremental improvements in traditional budgeting, while the latter calls for radical changes that would do away with budgets altogether. Between these polar positions lies advanced budgeting, which aims at integrating various proposals for change in the planning process to increase its quality and simultaneously lowering its cost. The specific combination of instruments necessary for implementation of advanced budgeting, however, varies across organizations and stages of development. Thus, for example, employment of rolling budgets or continuous forecasts may prove useful in one company, but not in the next.

According to its advocates, one of advanced budgeting’s important characteristics and great advantages is the possibility of its gradual implementation within an organization. Managers and employees learn how to use the new system step-by-step and consequently fewer problems are likely to occur during the introductory phase. Over time, the system’s users become increasingly adept in applying its instruments and can plan operational measures without difficulty. Accompanying this development is a forced reduction in the importance of classical budgeting specifically, or even of budgeting in general.

### 3. Empirical results pertaining to advanced budgeting

#### 3.1 Planning contents

Further development of planning and budgeting processes necessitates taking all components of the planning system into consideration. The companies participating in

Horváth & Partners' CFO-panel have many ideas for improvements. Figure 2 lists their most important reform proposals and shows the percentage of respondents supporting each of them.

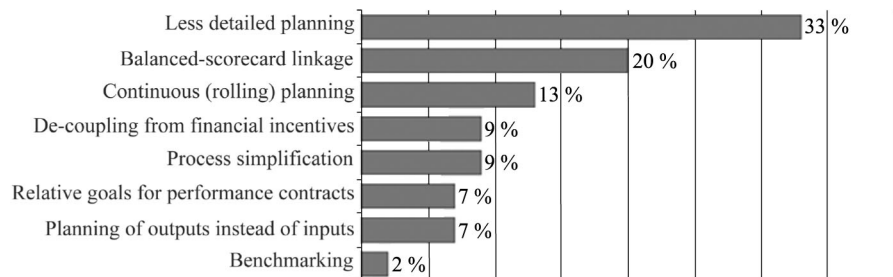
The most frequently mentioned concepts involve the amount of detailed planning content. Next, comes employment of a balanced scorecard linking operational and strategic planning. In third and fourth place, respectively, are the use of rolling budgets and the decoupling of planning from firms' incentive schemes. Growing numbers of enterprises use both of these modern measures in pursuit of greater continuity and flexibility in their planning and controlling systems. Also included among the reform concepts are other steps to simplify the planning process, use of relative goals in personal performance contracts, increased emphasis on planning outputs rather than inputs, and goal-setting via best-practice benchmarks.

On the basis of these survey results, Horváth & Partners have organized panel discussions around the topics of planning contents, processes, methods, and instruments. In addition, they continuously research the current state of IT-support for planning and budgeting purposes.

With respect to planning contents, the objective is to reduce complexity by decreasing the amount of detailed budgeting. Panel members view the high degree of detail in most budgets as the root cause of higher planning costs. One-third of the CFO-panel's firms regard reduction of budget detail as the most effective lever for improving their planning systems. Figure 2 shows no other proposed measure enjoying comparable support.

Consequently, every company should check whether a high degree of detail adds value for management purposes. It well may fail to do so. Instead, greater detail may result from executives' efforts to gain more control over their subordinates or from operational managers' needs for greater security. Observation suggests that the classic 80:20-relationship for much of business practice also applies to planning and budgeting: 20 per cent of the cost accounts comprise 80 per cent of an enterprise's total expenses (Leyk, 2006).

Rather than pay the high price of planning the remaining 20 per cent of these accounts, one simply can forego it. For purposes of control and security, comparisons of actual results from the prior and current periods often are adequate. In such instances, the scant utility gained from making comparisons between the budget plan and actual results does not justify the higher costs involved.



**Figure 2.**  
Level of support for  
reforms in planning and  
budgeting

Source: Adapted from Leyk *et al.* (2006)

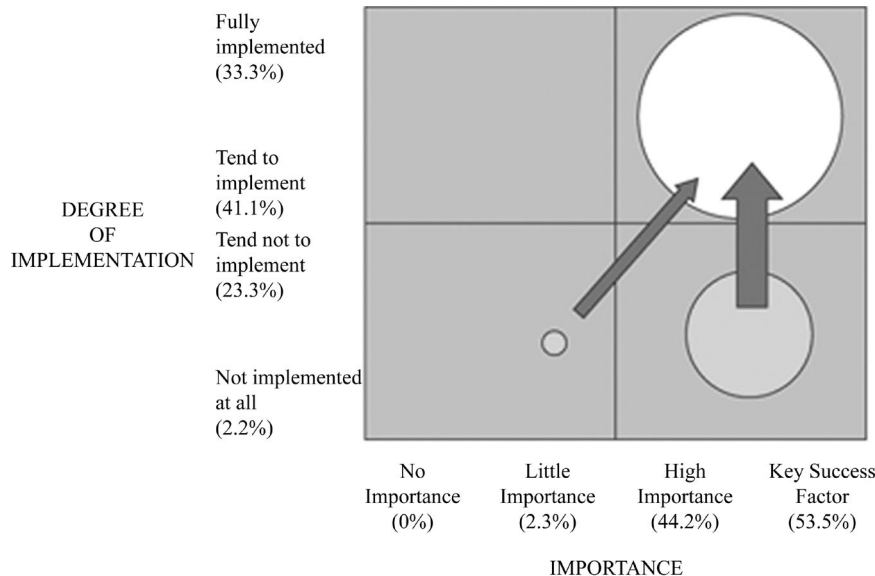
This insight of the panel participants suggests a new trend in planning and budgeting. Increasingly, they question the actions they themselves are taking in controlling and budgeting, and thus the tasks traditionally undertaken in these areas.

### 3.2 Planning processes

According to the Horváth & Partners CFO-panel, integration of strategic and operational planning represents the second most important lever for the further development of planning and budgeting (Figure 3). By employing it successfully, a company can boost the utility of budget planning, while at the same time permanently lowering the associated costs.

Many enterprises view their strategic and operational planning as two wholly autonomous areas, completely separated from one another both organizationally and with regard to their contents. Examining these areas more closely, however, reveals both of them to be parts of a larger, integrated process. In that process, top management's strategic planning establishes the framework within which operational planning and the subsequent execution of business transactions occur. Conversely, operational planning and budgeting supply starting points for deciding how the entire management team intends to attain the strategic goals set for it. Thus, one needs to coordinate the strategic and operational planning in a single, integrated process, characterized by continuous feedback and organizational learning (Kopp and Leyk, 2004).

In its integrated planning, the top-down assignment of specific, disaggregated operational measures, valued in monetary terms, to a company's divisions or lines of business has special importance for attaining strategic goals (Figure 3). Members of the Horváth & Partners CFO-panel almost unanimously view this aspect as the



**Figure 3.**  
Importance and  
implementation of specific  
measures in attaining  
strategic goals

Source: Adapted from Leyk *et al.* (2006)

quintessential, key success factor in planning and budgeting. The goals and measures involved constitute the concrete connections between strategic and operational planning. Surprisingly, though, more than one quarter (23.3 per cent + 2.2 per cent = 25.5 per cent) of the respondents say they have not yet incorporated such specific linkages into their business practices.

Furthermore, more than 40 per cent of panel members review their strategic goal attainment at most just once annually, while many of them do so even less frequently. That has two major consequences. First, they neglect analysis of their strategic goals. Second, they therefore often derive no operational measures from these goals. Consequently, it hardly surprises that more than half the surveyed enterprises give their own strategic controlling school grades of 3 or worse. The firms indeed may recognize the importance of and the potential for improvements in their planning. Whether such recognition will lead to positive changes on a large scale in the near-term future, though, appears questionable. Such skepticism seems especially warranted given the dearth of successful case studies illustrating how to implement advanced budgeting successfully.

The absence of appropriate starting points for specific operational measures based on a generally accepted enterprise strategy is a major source of inefficiency in the planning process (Horváth, 2003). Without such clearly identified starting points, planning units somehow must anticipate the direction in which top management wants to move. Typically, they simply extrapolate from previous plans, although mere extensions of past trends seldom predict the future well. In many cases, top management does not begin to analyze individual cost positions before the controlling service has completed and presented its initial budget draft. If, as usual, that draft does not agree with top management's vision, everyone involved has to make repeated runs through the planning loop. That prolongs the planning process unnecessarily. If, in contrast, one could start from clear, strategic goals top management has derived from the company's *Leitbild*, the planning process could begin much later. Additionally, the planning assumptions would be more current and useful. Over and above these advantages, one also would reduce the amount of resources consumed by planning and budgeting.

The problem of specifying strategic goals and assumptions can be greater or smaller, depending on the planning methodology employed. Generally one can distinguish among three different planning procedures: bottom-up; top-down; and mixed bottom-up/top-down.

Bottom-up planning begins on the operational level. There one asks oneself, "What could we attain, if we only had the requisite inputs at our disposal?" Working together closely, operational management and the controller service then develop an initial budget draft. Its contents essentially comprise a wish list. As top management's priorities manifest themselves during subsequent rounds of negotiations, more realistic values replace the original goals on this "dream sheet."

In contrast, top-down planning starts with top management deriving goals from the enterprise's *Leitbild* and developing strategies for reaching them. These strategies, in turn, represent the starting point for planning and budgeting, in the course of which operational managers formulate specific objectives and measures intended to realize top management's strategic vision. If reduction in the amount of time required for planning time is the primary concern, then the top-down method is preferable to the other two procedures because it renders superfluous most of the negotiating rounds associated with budget preparation.

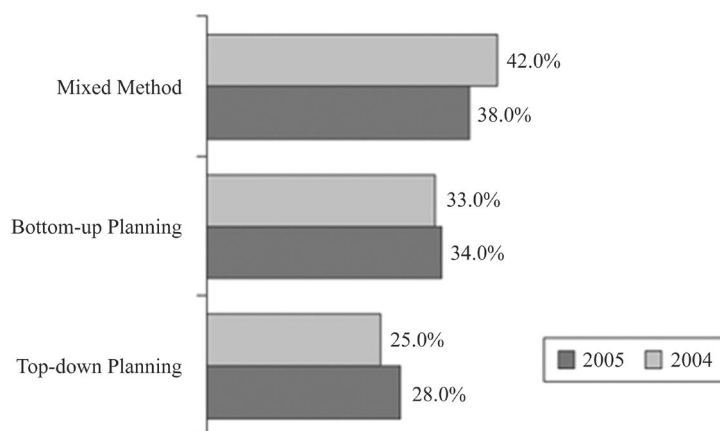
The mixed bottom-up/top-down method is a hybrid procedure. With it, one compares bottom-up planning results with starting points generated in top-down planning. A subsequent adjustment process then brings them gradually into agreement with one another.

Results from the Horváth & Partners CFO-panel questionnaire show that the absence of starting points for goal-setting and the time-consuming bargaining rounds still are widespread. Only 28 per cent of the surveyed firms rely on top-down planning. That percentage is a bit higher than the 25 per cent in 2004, but it still is too early to conclude the 3 per cent increase clearly indicates a trend toward increasing acceptance of this concept (Figure 4). In any event, according to panel participants, realistic assumptions and proposed goals are important factors for employing top-down planning successfully (Figure 5).

### 3.3 Methods and instruments

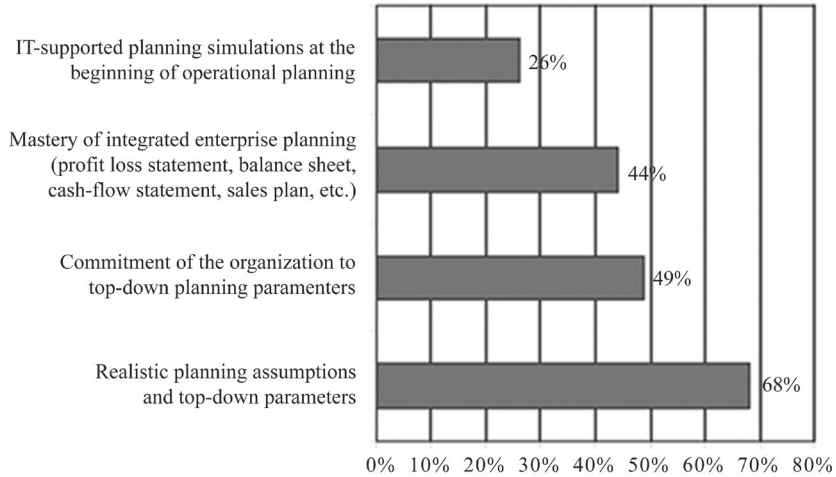
Horváth & Partners regard historically oriented, static budgets as outmoded. Like many other researchers and consultants, they therefore advocate a change to more flexible, future-oriented controlling systems. However, most enterprises still remain committed to the old-fashioned, static annual budget as their primary controlling instrument. They continue to plan on a yearly basis without taking into account ever shorter product life cycles and the increasing competition resulting from regionalization and globalization. If one insists on planning on the basis of annual budgets, though, one especially needs accurate forecasts in order to steer the organization effectively toward top management's goals. It would be even better, if one made the budgets more flexible by supplementing these forecasts with a rolling planning process and decoupling planning from the managerial compensation system.

By means of a rolling plan, one can integrate forecasting, planning, and budgeting, thereby overcoming the three functions' isolation from one another (Rickards, 2007a). Additional advantages of proceeding in this fashion lie in the resulting more reliable, exacter planning outcomes and the lowering of associated costs, because all three activities are continuously on-going instead of occurring only once annually.



Source: Adapted from Leyk *et al.* (2006)

**Figure 4.**  
Use of various planning  
methods in 2004 and 2005



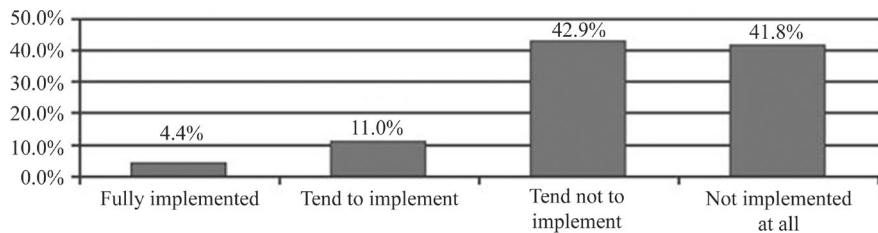
**Figure 5.**  
Factors essential for successful implementation of top-down planning

Source: Adapted from Leyk *et al.* (2006)

Furthermore, focusing rolling plans on shorter time intervals is advantageous too. Disaggregating long-term goals into shorter periods facilitates the scheduling of specific, concrete measures and controlling the progress made in implementing them. The management team thus can implement an enterprise's strategy more effectively.

Survey results from the Horváth & Partners CFO-panel underscore firms' failure to recognize or avoid the pitfalls associated with longer planning timeframes. The majority of respondents thinks the problem has little or only small significance. Moreover, almost 90 per cent of them say they plan over longer time periods without scheduling any concrete measures (Figure 6). In addition, more than half of the interviewees place little or no value on using sensitivity analysis to plan for various possible scenarios (Figure 7).

The CFO-panel participants think even less of decoupling executive compensation from the budget. According to Horváth & Partners, only 22 per cent of the companies contemplate cutting the connection between annual operational planning and managers' personal performance contracts. That linkage, however, leads to dysfunctional behavior and costly negotiations because the goals set for operational managers conflict with the executive leadership's priorities. Top management seeks successful implementation of its strategies and attainment of its objectives, while



**Figure 6.**  
Percentage of participants planning specific measures for short-term scenarios

Source: Adapted from Leyk *et al.* (2006)



operational managers strive for the largest possible yearend bonus. To increase their chances for a maximum bonus, cost center managers tend to inflate their real resource needs in their initial budget requests as a buffer against later rounds of cuts. In contrast, top management normally begins its planning by assuming a high level of sales revenue generated at a low cost level. Operational managers then put forward a minimalist counterproposal with regard to their outputs.

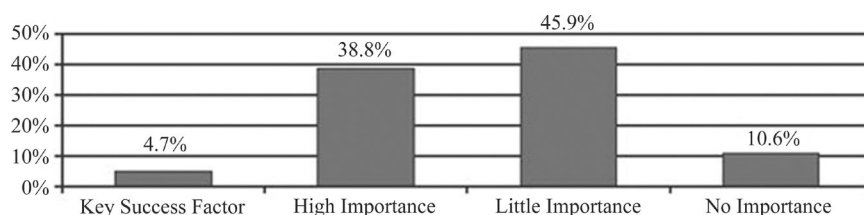
This situation results in repeated, costly, non-value-added runs through the planning loop, in an effort to uncover hoarded resources and underutilized performance potential. The final, approved budget constitutes a compromise reached somewhere between the two extreme initial positions. Given the wastefulness such budget games entail, separating management incentive schemes from budget goal attainment seems to be a sensible measure. Horváth & Partners therefore propose, wherever possible, replacing *ex ante* negotiated budget goals with adjusted prior-year data, benchmarks, or relative goals as bases for *ex post* evaluations of actual performance.

#### 4. IT-support

Without capable, efficient IT-support, implementation of a rolling budget concept is infeasible. With such support, though, one can improve the quality of the planning and controlling information delivered as well as markedly facilitate implementation of an advanced budgeting concept (Horváth, 2003). The CFO-panel clearly shares this view. Over 90 per cent of the enterprises regard good IT-support either as a key success factor or as a factor with great significance for controlling (Figure 8). According to Horváth & Partners, the result also shows firms recognize the crucial importance system support has for operational planning.

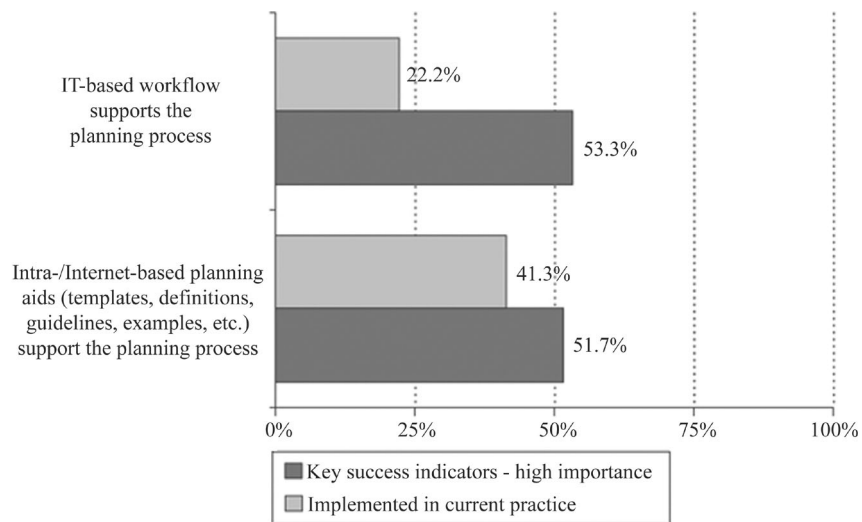
Yet at the same time, about one-third of the respondents say their own company's IT-support is not good. Among other reasons, their dissatisfaction stems from the tools employed for operational planning. Likewise only about one-third of the enterprises use any sort of specialized planning software, while more than 90 per cent of them rely mainly on Excel spreadsheet calculations.

In the operational area, Horváth & Partners thus see considerable potential for improvements, which they urge controller services to put into practice. Exactly how to increase planning efficiency through employment of high performance planning tools linking strategic and operational controlling is, however, a question they and their CFO-panel fail to address. Their collective silence in this regard is especially noteworthy because they assert that planning in less detail and connecting plans to balanced scorecards are the two most powerful levers for improving controlling systems.



Source: Adapted from Leyk *et al.* (2006)

**Figure 7.**  
Perceived importance of  
planning specific  
measures for short-term  
scenarios



**Figure 8.**  
Importance of IT-support  
in theory and in practice

Source: Adapted from Leyk *et al.* (2006)

### 5. Conclusions regarding advanced budgeting in current practice

The CFO-panel survey's results show empirically that there is substantial potential for improvement in the efficiency and effectiveness of enterprise planning. The results also confirm that the participating firms recognize these problems and intend to tackle them with modified or entirely new controlling concepts in the near future. Horváth & Partners find the surveyed companies increasingly feel they must take action. Clearly, the changes sought pertain to all aspects of planning and budgeting: processes, contents, methods, and instruments. Nevertheless, enterprises still do not pay sufficient attention to the principle of continuity in their planning, and thus to the necessity of creating more flexible budgets. Furthermore, the IT-support currently in place is largely incapable of supporting the needed reforms, even ones exclusively involving the operational area. As explained next, linking operational and strategic planning will be many times more difficult.

### 6. Success factors for an integrated enterprise controlling system

The term "corporate performance management" (CPM) appeared for the first time in professional controlling literature around the year 2000. Synonymous terms are "enterprise performance management" (EPM) and "business performance management" (BPM). The new terminology implies that CPM comprises far more than merely preparing the key performance indicators in controlling reports as the basis for top management's decisions or applying "business-intelligence" technologies. With the help of integrated, analytical processes, CPM's purpose is to support development and operational implementation of enterprise strategies. To do so, these processes must work with both non-financial and financial data.

In contrast to "enterprise resource planning" (ERP), however, no one soon will be able to buy CPM "off-the-shelf." The reason why lies in the fact that recognized best practice thus far has established itself in only a few areas of business administration. A

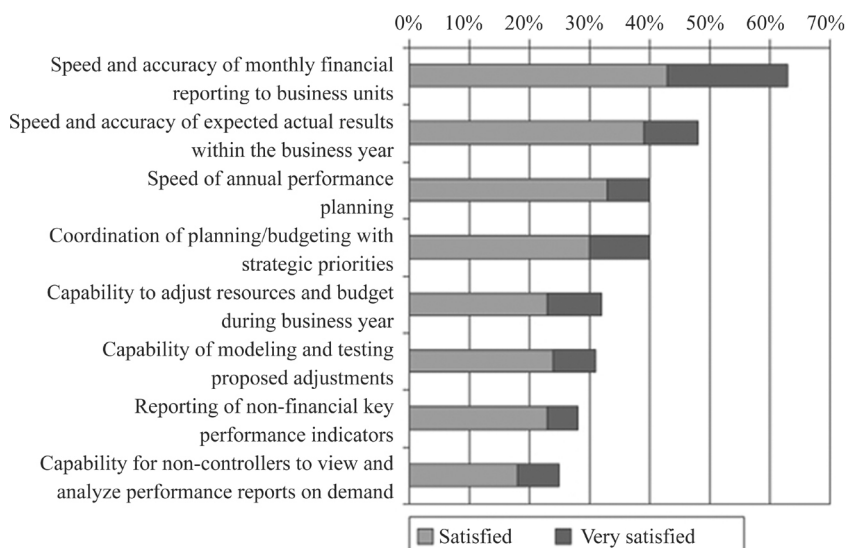
starting point in this regard might be a concept similar to the balanced scorecard: Specification of goal systems in the form of cause-and-effect diagrams and reports on the progress made toward quantitative targets, grouped according to perspective, today are virtually standard practice (Oehler, 2006).

While some ideas about an appropriate starting point thus are in circulation already, the road to a comprehensive IT-support system for CPM will be long. Figure 9 summarizes key results from another CFO-survey. It shows a high degree of satisfaction with IT-support for classic controlling responsibilities like financial reporting and preparation of prognoses. Yet for integrated tasks like generating rolling forecasts and reporting non-financial indicators as well as the use of applications by lay people, there remains great potential for improvement.

Recent attempts to find an adequate answer to the question of integrated system support resemble earlier efforts to develop accounting software to aid operational activities. Starting from isolated, “insular” solutions, developers gradually linked the programs involved, producing integrated ERP-solutions, which nowadays provide comprehensive support for an enterprise’s operations. Creation of an integrated CPM, though, lags the development of ERP-systems by a decade or more. Nonetheless, MIS, Hyperion, and SAP have begun offering “integrated” CPM-systems for business transactions. In the future, they hope to meld the analytic with the transactional world.

## 7. Integration

Integration plays a crucial role in CPM because it is a key factor in both IT and business administration. Its significance stems from the complexity associated with many questions. Dealing with such complexity first requires disaggregation of an overall problem into smaller, more manageable sub-problems. Next, individuals or teams solve the sub-problems by means of largely isolated procedures. But in order to



**Figure 9.**  
Satisfaction with  
IT-support for the  
performance-management  
process

Source: Oehler (2006)

attain useful insights or results, one then has to reassemble the various partial solutions in a meaningful context. According to the CFO-Research Survey, the need for integration constitutes the chief impediment to implementation of new controlling concepts (Figure 10).

Another survey shows that increasing demand for system integration is a rather recent development. In contrast, the lack of functionality in CPM-support has posed a big problem for a longer period of time (Figure 11).

So far, efforts at solving the integration problem have focussed chiefly on technology. In principle, the same technologies used for ERP also are available for completely integrating enterprise controlling. Yet these technologies only guide the exchange of data. Applications comprising several processes within ERP currently are in the very earliest phases of development. Nonetheless, increasing automation of individual processes, with the possibility of instantly accessing their most important key performance indicators, heightens the significance of technology. Figure 12 depicts important factors influencing CPM-automation. In particular, “enterprise application integration” (EAI) likely will increase pressure for support in real time and thus spur on the search for technological solutions.

It would be nice, if one simply could integrate CPM the way one did ERP. Why that won't work has less to do with technical than with conceptual considerations. The problem therefore does not lie with technology as such, but rather with the analytical processes and methods, which mirror the inclusion of CPM in an enterprise's overall controlling concept. How should the sub-processes interact? When must one coordinate

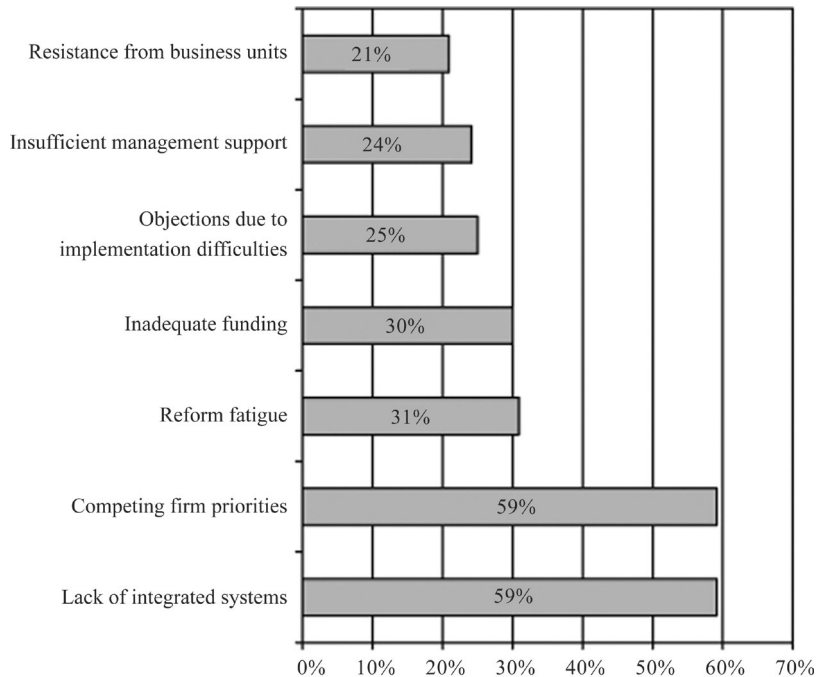


Figure 10.  
Obstacles to  
improvements in CPM

Source: Oehler (2006)

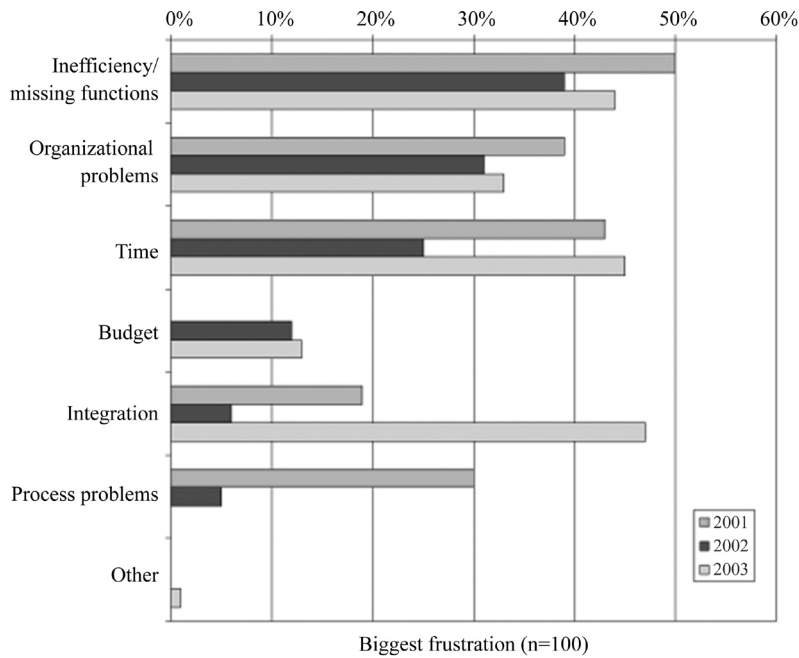


Figure 11. Frustration with CPM-support

Source: Oehler (2006)

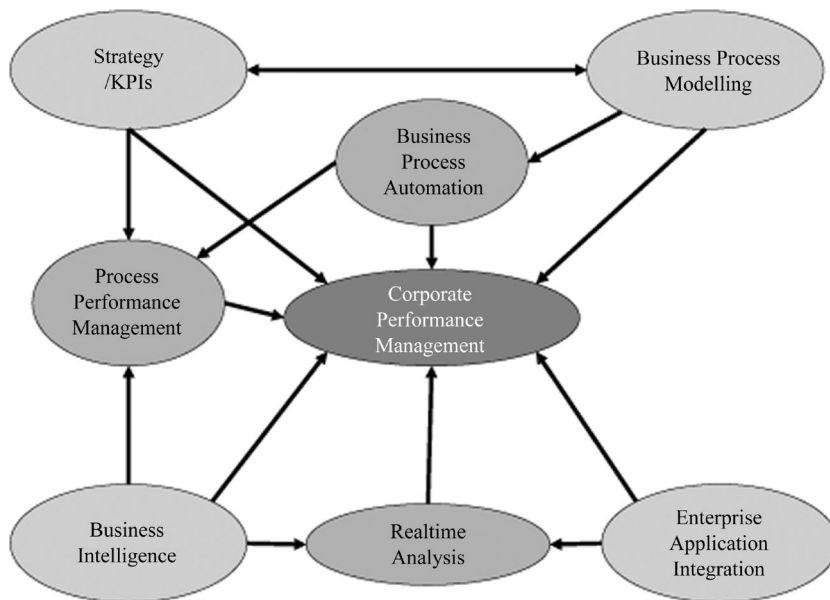


Figure 12. Variables influencing CPM-automation

Source: Oehler (2006)

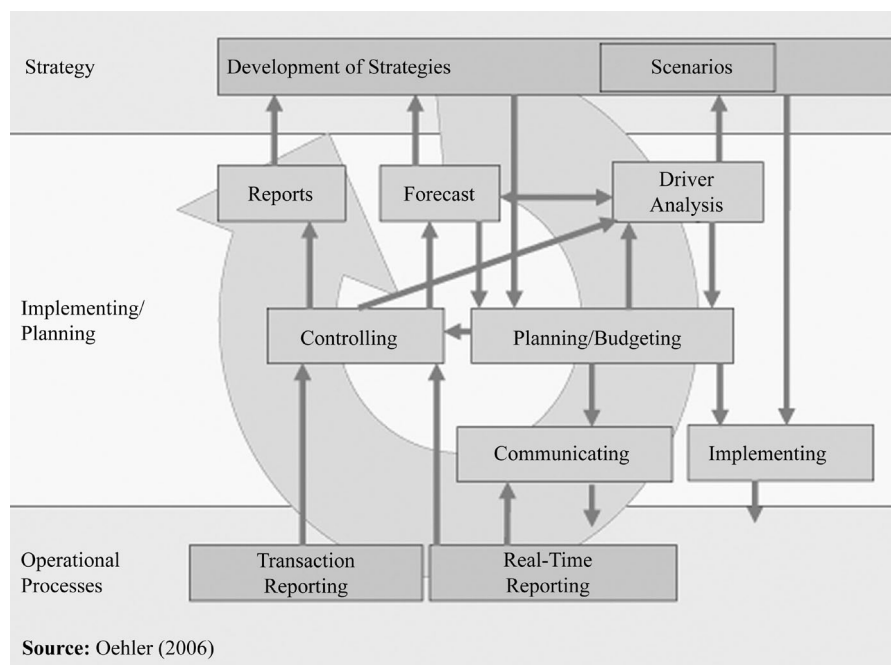
them with one another? In most companies, one searches in vain for answers to such questions. Several points make this cluelessness abundantly clear:

- In practice, few firms link strategic and operational planning with one another. Even having a balanced scorecard does not appear to help much in this regard. Only 15 per cent of the companies responding to a *Business Finance* questionnaire said that they had integrated their balanced scorecard and budgeting (Oehler, 2006).
- Risk management also is an insular system in most enterprises. Furthermore, besides the isolated pillars of strategic planning, operational planning, and risk management, firms currently are creating another new, isolated pillar with its own internal controlling system, namely, “corporate governance”.
- Over and above these problems, consolidating corporate financial accounting information for external reporting and management accounting data for internal reporting often are completely separate processes too.
- Finally, many different methods can overlap one another. For example, the European Foundation for Quality Management’s Model (EFQM-Model) and the balanced scorecard target the same area, but have a different background. The EFQM-concept stems from the “total quality” discussion, while the balanced scorecard pertains to strategy implementation. There is great uncertainty about how one should combine solutions to the two sub-problem into a single answer to a more complex, overall question.

Sticking one’s head in the sand like the proverbial ostrich and waiting for someone outside the organization to develop an appropriate solution is the worst reaction to this uncertainty. But one also can seek salvation in vain inside an enterprise. Gartner’s analysts, for example, offer a relatively simple recommendation: Having the best concept is not decisive, but rather having a concept, which all management decision makers accept (Oehler, 2006). If integration only were as easy as that! With regard to appropriate key performance indicators and the procedures needed to compute them, such political decisions may function acceptably. If, however, company executives must choose, say, between rolling forecasts and traditional budgeting, i.e. a more complex, much more important decision, then specialist expertise is essential to making the right choice.

Before one can tackle the topic of integration, one thus must develop a clear concept that fully encompasses as a single entity the cycle of planning goals, navigating a course in their direction, and controlling the progress made toward attaining them. Figure 13 illustrates the need for integration arising from such an all-inclusive concept.

Even in the case of small and medium-sized enterprises, the controlling system already operates on several levels simultaneously. Besides the various functional areas of administration, CPM therefore simultaneously must link strategic, operational, and tactical planning measures. Strategic CPM is associated with the balanced scorecard, while operational CPM has more to do with budgeting, monthly reporting, and “business activity monitoring (BAM)”. For its part, tactical CPM comprises short-term measures taken in order to react to discarded assumptions as well as strategic and operational mistakes.



**Figure 13.**  
Need for integration from  
an expert viewpoint

## 8. Conclusions regarding current IT-support

Because there are so many factors to take into consideration, every firm's management will have to construct a CPM-architecture suited to its own needs. To do so, it will have to decide which processes one has to go through, which methods to apply, which data to transfer, and which organizational units to charge with responsibility. After there are answers to all these questions and the individualized concept is in place, it certainly is plausible that one might implement it with standard tools. Yet Horváth & Partners would seem well-advised not to hold their breaths until an IT-solution for the missing linkage between strategic and operational controlling becomes generally available for advanced budgeting purposes.

## 9. European automobile suppliers' controlling tools

Summing up the discussion thus far, whether large or small, many organizations are dissatisfied with their planning and budgeting. In response to their complaints, some management gurus advocate advanced budgeting as a remedy. Nevertheless, these proponents themselves complain about the lack of technical support, while IT-specialists cite the dearth of convincing concepts as well as successful and unsuccessful case studies. What exactly do enterprises, especially SMEs, which comprise the overwhelming majority of all firms, have in their controlling toolkits nowadays? A survey of the European automobile suppliers' industry yields some interesting answers (Dressler, 2006).

For many years, the Original Equipment Manufacturers (OEM) have exerted massive pressure on automobile suppliers to lower costs. Due especially to the efforts

of Ignacio López, the automobile industry permanently changed its working procedures in the 1990s. Hired initially at General Motors España, José Ignacio López de Arriortúa assumed responsibility as vice president for production and procurement of the corporation's German subsidiary, Adam Opel, in 1987. A year later, he already had advanced to chief of procurement for General Motors Europe. In 1992, as Executive Vice-President in the Detroit World Headquarters, he revolutionized GM's purchasing worldwide and forced the supplier industry to make unprecedented concessions. López generated huge cost savings for General Motors Corporation with his methods, making full use of GM's negotiating power *vis à vis* the suppliers. In this fashion, he saved General Motors over \$4 billion just between 1992 and 1994 (Moffett and Youngdahl, 1998.) However, his methods also severely strained GM's supplier relationships.

In 1993, López surprised many observers by leaving General Motors without advanced notice and joining Volkswagen (VW) AG's board of directors the next day. VW was having difficulty dealing with the competitive pressure exerted by Adam Opel. At VW's headquarters in Wolfsburg, Chairman of the Board Ferdinand Piëch created a new position for López, giving him executive responsibility for production optimization and procurement. Accordingly, López's switch to VW aroused suspicions of industrial espionage.

With his unprecedented methods, López played a decisive part in VW's subsequent turnaround. In 1996, though, when GM threatened VW with a lawsuit that ultimately led to tensions in US-German trade policy, López left VW to facilitate an out-of-court settlement. Admitting no wrongdoing, VW paid GM \$100 million in cash and agreed to purchase parts from it for \$1 billion. VW's settlement with GM consequently put additional cost pressure on German automobile suppliers.

Since the dawn of the López era, the European suppliers' industry has shrunk continuously, leaving ever fewer players. Competitive pressure worldwide generally, and in the European automobile industry in particular, is enormous. Sometimes this pressure has given rise to unusually lean production and logistical processes. In the wake of consolidation, suppliers also increasingly have sought contracts with large automobile manufacturers outside their home markets. Today, there are many more transactions across inner-European borders in an industry, where German-German, French-French, and Spanish-Spanish relationships formerly were typical (Kanter and Dougherty, 2006). Partnership models have made even better use of capacity possible. Furthermore, the decision to be onboard as a preferred supplier for a model group has attained strategic significance (Kinkel and Lay, 2003).

To be effective, instruments for cost center accounting, budgeting, and product profitability analyses (to optimize production portfolios) have to be in the controlling toolkit of every automobile supplier. Only an effective controlling system enables them to calculate highly detailed, profitable prices, while revealing potential for further cost reductions, and thus securing their thin contribution margins. Otherwise suppliers could not survive the industry's murderous competition. But to what extent do they also use more modern, innovative controlling tools?

- Do they employ balanced scorecards (BSCs) with key performance indicators (KPIs) to achieve their strategic goals?
- Has the Anglo-American focus on shareholder value assessment (SVA) also achieved a breakthrough in (Continental) European controlling?



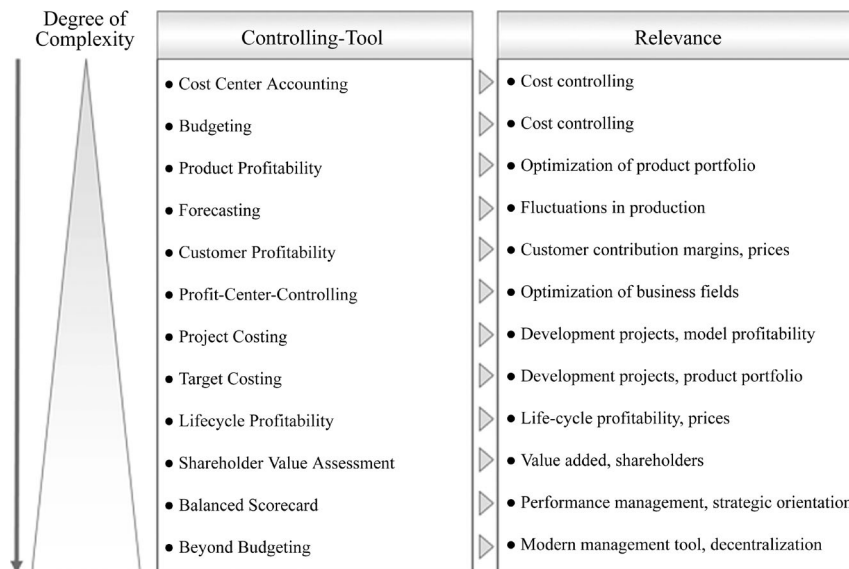
- What role does beyond budgeting play?
- The automobile industry itself moves in the tempo of various models' life cycles – but do suppliers regularly conduct life cycle analyses in order identify time points when intervention may be necessary?

These questions were the central elements of an international research project “Application of Advanced Controlling-Tools in the Automotive Supplier Industry – A Four Country Analysis,” conducted in cooperation with the FhTW Berlin in 2005. In conducting the project, investigators examined the controlling tools of 100 SME-automobile suppliers in France, Germany, Great Britain, and Poland. Figure 14 lists the 12 tools studied, together with an indication of their relevance for controlling and relative degree of complexity.

The simplest instrument covered by the project was cost center accounting. One does not need much business administration expertise to form cost centers and allocate primary and secondary costs to them with readily available, basic standard software. But the complexity encountered in using a specific controlling tool also originates from the context of a given situation, the particular software used, and the degree of detail sought. Thus, a highly iterative budgeting process involving thousands of transaction accounts and hundreds of cost centers can be more complex than a balanced scorecard, based typically on 16-20 variables and for which one can obtain values automatically from a previously defined data set.

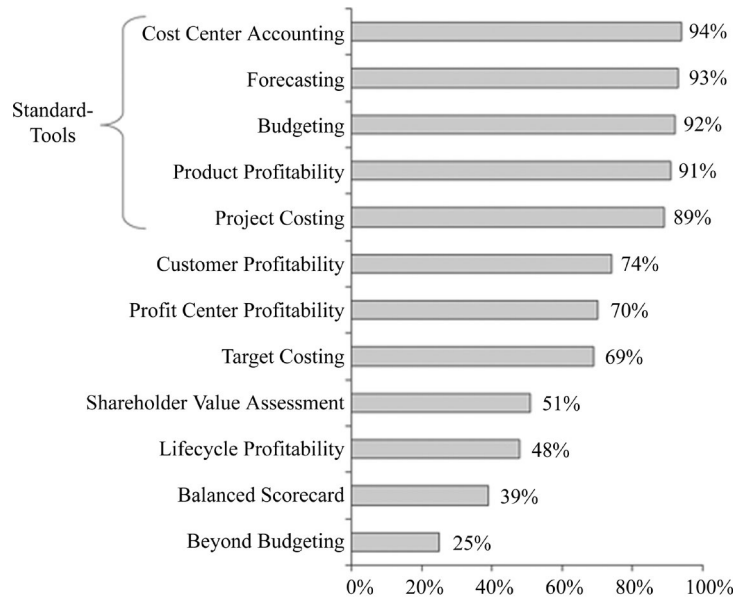
### 10. Application of the controlling tools in general

Four tools, which the researchers term the “standard set,” are in the controlling toolkit of more than 90 per cent of the surveyed supplier firms (Figure 15). These tools are:



Source: Dressler (2006)

Figure 14.  
Degree of complexity and  
relevance of surveyed  
controlling tools



Source: Dressler (2006)

**Figure 15.**  
Regular or occasional use  
of surveyed controlling  
tools in four European  
countries

cost center accounting (94 per cent); forecasting (93 per cent); budgeting (92 per cent); and product profitability analyses (91 per cent). With an 89 per cent employment rate, project costing arguably also belongs to the standard set.

For cost center accounting one creates centers, where costs originate and one controls them. In doing so, one allocates both primary and secondary costs to these centers. Expense distribution and overhead allocation sheets normally constitute the respective bases for such allocations. In addition, the firms studied have efficient budgeting systems that assign plan costs to the cost centers. Accordingly, their controller services regularly compare plan, flexible budget, and actual cost figures in order to guide the enterprises toward their profit goals.

Swings in production output continually pose a risk factor for overall profitability. In many cases, one can offset them partially through pricing agreements, but even the best planned selling price can not entirely compensate for the financial effects of varying capacity utilization. The ability to create forecasts from market data and to integrate them in budget planning therefore has become an essential skill in automobile supplier industry.

As explained above, in order to attain or retain the status of a preferred supplier for a model group, firms often must accept razor-thin unit contribution margins. Their long-run survival therefore depends on controlling the profitability of the components they deliver exactly. This necessity, in turn, has made product profitability accounting a standard tool.

Furthermore, cooperative product development in model groups requires a project-oriented work style. Project accounting thus is one of the most frequently used controlling tools and accordingly probably belongs in the standard toolkit too.

In contrast, analyses of customer profitability (74 per cent) and profit center profitability (70 per cent) as well as target costing (69 per cent) are in widespread, but not yet universal, usage. The fact that, as a rule, the typical automobile supplier enters into only a handful of cooperation agreements further heightens the need to calculate customer profitability precisely. Moreover, knowledge about customer contribution margins and the profit centers earning them is essential to securing adequate margins for individual products in price negotiations. At the same time, increasing transfers of automobile manufacturers' R&D activities to their suppliers, in combination with the aforementioned thin margins, apparently leads to frequent employment of target costing.

Shareholder value assessments (51 per cent), lifecycle accounting (48 per cent), and balanced scorecards (39 per cent) enjoy much less extensive usage. That only half of the firms employ shareholder value assessments reflects the strong reservations many suppliers have about this instrument, especially in Germany.

On the other hand, conditions are more favorable for expanded use of life cycle accounting. The ability to control products and their performance precisely requires suppliers to take a longer time perspective. Given their increasing responsibility for R&D, while simultaneously having to cope with wide output fluctuations and volume pricing schedules, a supplier must be able to estimate a product's value over its entire life cycle. Consequently, life cycle accounting is becoming an important tool, which many automobile suppliers already use.

Its frequent utilization is particularly impressive given the relatively complex know-how necessary for the tool's effective employment. Taken together, obtaining the requisite data from various sources, putting them into a logical relationship with one another, and then analyzing them in a methodologically clean fashion poses a considerable challenge (Hahne *et al.*, 2002).

In light of the many publications extolling the balanced scorecard's general acceptance, the employment rate reported for it here appears rather low. As explained earlier, the instrument's infrequent usage probably does not arise solely from its complexity. Instead, the small size of most supplier firms very likely is an additional cause. Especially in SMEs, attempts to develop and implement a balanced scorecard are fraught with numerous difficulties (Rickards, 2007b).

Of the tools studied, the surveyed firms employ beyond budgeting concepts the least frequently (29 per cent). A plausible explanation for this result is that beyond budgeting itself is not a single instrument. Instead, it is a concept that seeks to replace budgeting with a leadership model based on numerous, more modern management tools such as BSCs, activity- and value-based management, rolling forecasts, benchmarking, and radical decentralization of responsibility (Hope and Fraser, 2003). It actually has little to do with whether or how an enterprise should execute, simplify, or even discard its planning. Rather, it is mostly about a fundamental management philosophy, in which questions pertaining to worker motivation play a large role. Beyond budgeting nonetheless interests controllers because many of its advocates take an empirical approach that focuses on self-motivation.

Yet restricting planning issues largely to their motivational aspects is not particularly satisfying for controllers. After all, they also plan in order to determine an enterprise's need for, say, investment or personnel, or to make binding, short- and

medium-term commitments (Schnell, 2007). Such firm commitments are essential to activities in areas like logistics and production, for example.

Whether one in fact can increase self-motivation successfully with the cornucopia of beyond-budgeting-instruments remains an open question. However, the complexity involved in implementing beyond budgeting surely is the largest among the twelve tools examined, because it tries to integrate so many different and challenging instruments with one another. In particular, small automobile suppliers, with fewer than 100 employees, are unlikely to have sufficient know-how in-house to introduce a beyond budgeting concept, even with help from external consultants.

### 11. International comparison of the employment of controlling tools

Comparison of the survey's results across the four countries involved leads to generally similar insights (Table I). The standard toolkit enjoys a dominant position with controller services in all of them. In contrast, British firms employ shareholder value assessments at a much higher rate (88 per cent) than either their French and German counterparts (53 per cent and 32 per cent, respectively) do. For their part, Polish suppliers rely on shareholder value assessments even more (90 per cent) than British enterprises. The position of German enterprises on the other end of the usage scale suggests they urgently need to change their thinking. Especially in countries strongly influenced by Anglo-American controlling, shareholder value orientation already has become an instrument in the standard toolkit.

On the other hand, employment of beyond budgeting is much less widespread. Due to its many-sidedness and need for special controlling know-how, it now finds little acceptance among SMEs. Be that as it may, Polish firms appear to be considerably more inclined to use it than are companies in the other three nations. Given contrary results from a similar survey in the Czech Republic (Fibirova and Soljakova, 2007), which joined the European Union at the same time Poland did, this surprising finding deserves further investigation. Why are Polish, but not Czech, companies more "Anglo-Saxon" in their budgeting practices than British ones?

In any event, detailed analysis shows further, that most of the relatively few British, French, German, Polish, and Czech firms already working with beyond budgeting still continue to use traditional budgets in a supporting role for controlling purposes. Hence,

	France (%)	Poland (%)	UK (%)	Germany (%)
Budgeting	82	100	100	91
Forecasting	76	100	100	95
Cost center accounting	82	90	100	96
Project costing	88	80	100	88
Target costing	71	90	69	64
Customer profitability	53	70	69	82
Profit center profitability	71	50	81	70
Shareholder value assessment	53	90	88	32
Lifecycle profitability	76	10	50	46
Balanced scorecard	24	40	38	45
Beyond budgeting	29	40	19	23

**Table I.**  
Employment of  
Controlling Tools in Four  
European Countries

Source: Dressler (2006)

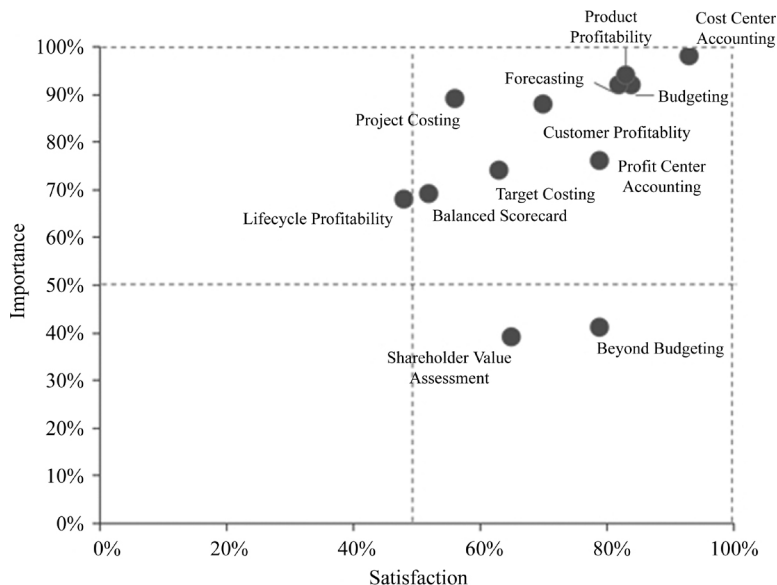
it may be more appropriate to regard them as employing advanced budgeting concepts rather than beyond budgeting *per se* (Gaiser *et al.*, 2004).

### 12. Importance and usage of selected controlling tools in Germany

German suppliers view the standard tools (cost center accounting, budgeting, forecasting, and product profitability analyses) as the most important ones (Figure 16). Thus, the importance and usage of these tools (Table I) stand in agreement with one another with values of more than 90 per cent on each of the two dimensions. Major differences between importance and usage, though, appear in connection with the balanced scorecard and life cycle accounting. While 68 per cent of the German enterprises surveyed see the latter as important, only 46 per cent of them employ it. The discrepancy in the case of the balanced scorecard is even larger: here 69 per cent of respondents regard this tool as very important, but only 45 per cent actually use it.

### 13. Importance of and satisfaction with controlling tools in Germany

When directly compared, a high correlation between the importance of and satisfaction with the standard tools is readily evident. All four instruments have values exceeding 90 per cent with respect to their importance, and their values for satisfaction are all above 82 per cent. There are several reasons for these high scores. First, recognizing the importance of an efficiently functioning controlling service, many German SME-suppliers have invested heavily in this area in recent years. Further, suppliers need dependable job cost accounting in order to meet the OEMs' demands for greater transparency in their pricing calculations. Due to the advances made in developing software for key performance indicator systems and reporting, many small and mid-sized controlling services now are able to transfer data from their accounting



**Figure 16.**  
Importance of and  
satisfaction with surveyed  
controlling tools

Source: Dressler (2006)

systems directly into their controlling applications. Their ability to do so, in turn, presumably leads to a higher degree of satisfaction. Also contributing to that higher satisfaction are the software solutions, which enterprises have developed in-house. For example, SMEs themselves have developed on an Excel-basis about 90 per cent of the software tools they use for planning purposes (Dahnken *et al.*, 2003).

In contrast, great discrepancies between importance and satisfaction occur with regard to four other controlling tools: project controlling (importance: 89 per cent, satisfaction: 56 per cent); target costing (74 per cent, 63 per cent); balanced scorecard (69 per cent, 52 per cent); and life cycle accounting (68 per cent, 48 per cent). The results underscore what a great challenge it is, especially for SMEs, to master the complexity associated with employment of these tools. Because there scarcely is any standard software available for target costing or life cycle accounting tailored to the needs of SMEs, the suppliers find it difficult to use them.

The above discrepancies offset the close association between importance and satisfaction with regard to the standard controlling tools as well as shareholder value assessment and beyond budgeting. (The two latter instruments have low values both for importance and satisfaction). It therefore is unsurprising that the overall relationship between importance and satisfaction for the dozen tools studied is weak ( $r = 0.37$ ).

#### 14. Conclusions and areas needing attention

The standard tools have attained a high degree of acceptance and satisfaction with European supplier firms generally and German enterprises in particular. The importance of cost control to them is abundantly apparent in the high scores they give cost center accounting, budgeting, and forecasting. The fact that over 90 per cent of the surveyed companies also use product profitability analyses is impressive because a decade ago knowledge about product profitability was not necessarily part of their standard repertory. In this regard, though, the research team did not explore whether the enterprises understand product profitability as an amount based on standard or actual costs or merely the result of job order cost calculations.

The extensive use of all four (or five) standard instruments is indeed impressive, but in keeping with other studies' findings (Schäffer and Steiners, 2005). A firm that does not employ them in its standard controlling risks falling behind the competition. Moreover, the suppliers' high degree of satisfaction with the standard tools leaves scarcely any room for improvement. This finding sends a clear message to all practitioners, who groan about the time and effort expended in preparing and analyzing their monthly budget reports.

The more complex tools are another matter. In order to close the gap between perceived importance and degree of satisfaction, four tools require improvement or simplification: project controlling; target costing; the balanced scorecard; and life cycle accounting. These instruments are difficult to use with off-the-shelf software. Furthermore, their use presupposes conceptual clarity about how to employ the tool and what one wants to attain with it. Where such clarity exists and a suitable cost accounting system is in place, one often may be able to generate meaningful results for the purposes of project controlling as well as target costing and life cycle accounting on the basis of simple Excel-applications.

In the case of the BSC, though, a comprehensive analysis of strategy and the identification of important success factors also must precede its introduction. Meeting these additional requirements typically involves an expensive project, which one only can complete successfully if one has the requisite expertise or obtains appropriate external support. Given the supplier industry's thin contribution margins, desires for a key indicator system, integrated in a strategic BSC-concept and simultaneously linked with the operational controlling system are likely to remain unfulfilled for a longer time.

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