

## BUDGETING AS A VALUABLE TOOL IN PREVENTING UNFAVORABLE BUSINESS DEVELOPMENTS

Budgeting is an important component of financial success. Nowadays many companies, instead of reacting in a panic mode to unfavorable developments, use the budgeting process to carefully plan in advance for a number of possible contingencies. Budgets are an integral part of management control systems, and when administered thoughtfully by managers, they promote coordination and communication among subunits within the company, provide a framework for judging performance and facilitating learning as well as motivate managers and other employees.

The budgeting process should involve all levels of management. This is very important when lower-level managers participate in the budgeting process because they have more specialized knowledge and first-hand experience with day-to-day aspects of running the business. Moreover, this participation creates greater commitment and accountability toward the budget among lower-level managers. This is the bottom-up aspect of the budgeting process [4].

We support the views of leading scientists that companies should go through the five-step decision-making process when budgeting, as shown in Illustration 1.

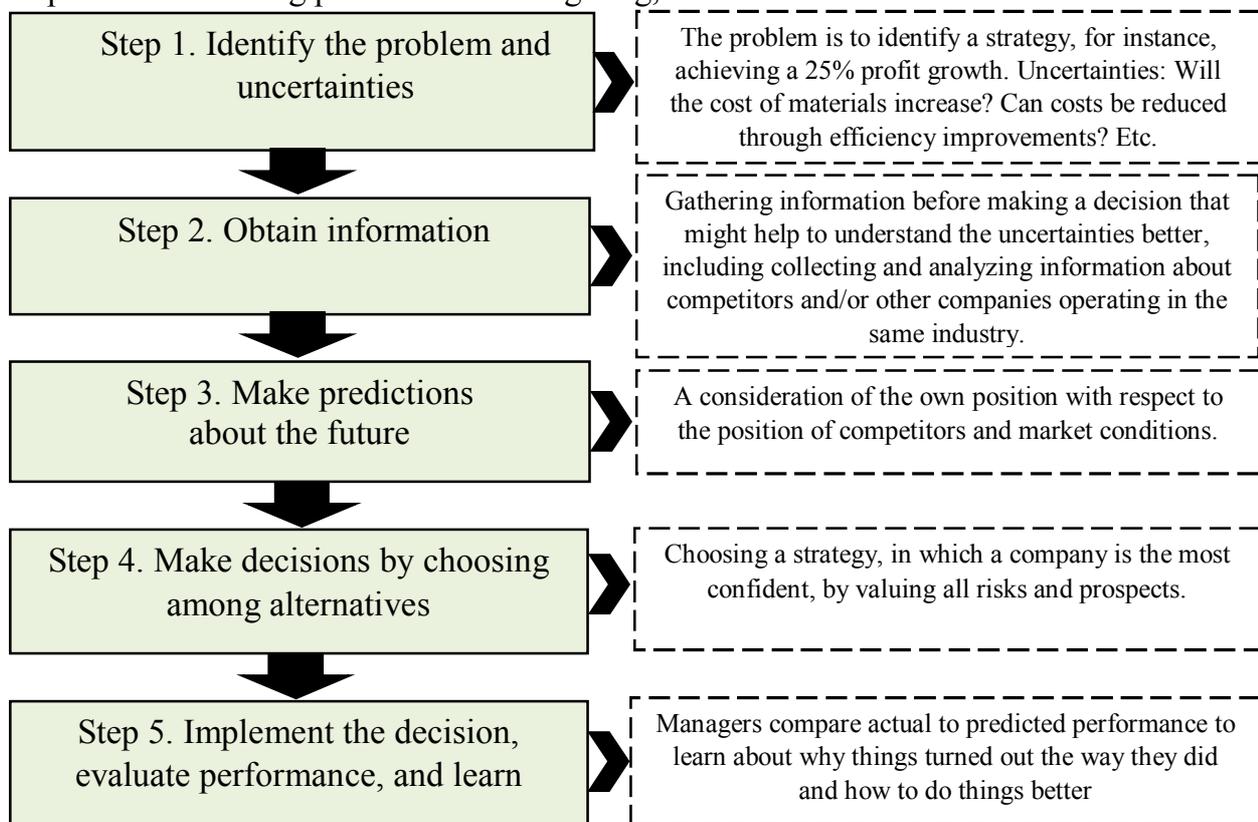


Illustration 1 Five-step decision-making process when budgeting

The central planning tool that a management team uses to direct the activities of a corporation, as well as to judge the performance of its various [responsibility centers](#), is a

master budget. The master budget summarizes the financial projections of all the company's budgets. Furthermore, it expresses management's operating and financing plans [3]. The master budget interrelationships are shown in Illustration 2.

It needs to be pointed out that running a successful budgeting program requires considerable interpersonal skills in addition to purely technical skills. What is more, to attain the goals, a company must coordinate the efforts of all its employees by assigning responsibility to managers who are accountable for their actions in planning and controlling human and other resources. Budgets coupled with accounting responsibility provide feedback to top management about the performance relative to the budget of managers of different responsibility centers.

Deviations from the budget, if properly used, can help managers implement and evaluate strategies in different ways. Firstly, by providing early warning to events that not easily or immediately evident. Secondly, by performing the evaluation of how well the company has performed in implementing its strategies. Thirdly, by evaluating strategy signaling that managers' strategies are ineffective.

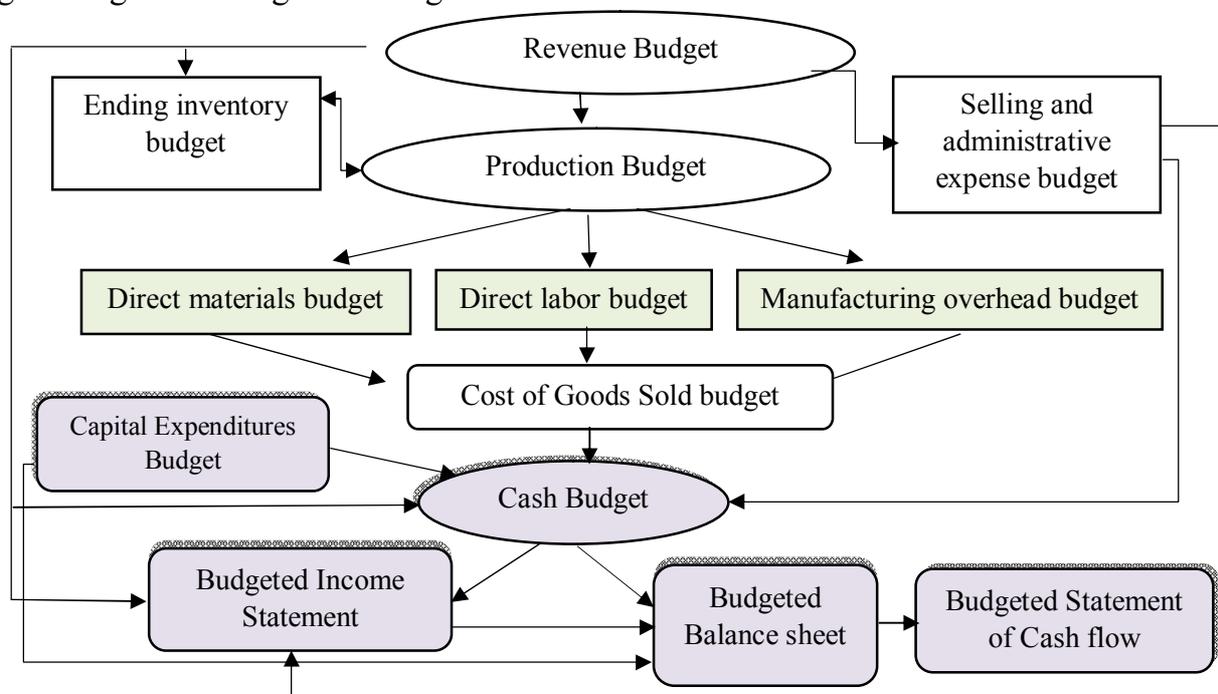


Illustration 2 Overview of the master budget interrelationships

As a result, many multinational companies find budgeting to be a valuable tool when operating in very uncertain environments. The purpose of budgeting in such environments is not to evaluate performance relative to budgets, but to help managers throughout the organization to learn and to adapt their plans to the changing conditions and to communicate and coordinate the actions that need to be taken throughout the company [4].

The important thing to remember is that oftentimes the budgeting process can be accompanied by budgetary slack. Subordinates may try to build in the practice of underestimating budgeted revenues, or overestimating budgeted costs, to make budgeted targets more easily achievable. To avoid problems of budgetary slack and see the true profit potential of the company, enterprises should evaluate managerial performance using multiple indicators that take into account various factors such as the prevailing business

environment and performance relative to competitors. In view of the budgetary slack practice, some organizations can use budgets primarily for planning purposes and in such way, avoid the problems. We believe that managers should involve themselves regularly in understanding what their subordinates are doing. Truth-inducing schemes also play an important role in reducing budgetary slack. The main goal here is to align the subordinates' interest with the management's interests. Some actions that the management can take in this case are, putting the subordinate on a fixed salary if he takes the right action or imposing a penalty if he contravenes. Another step could be to induce a compensation plan that links compensation with the subordinates' performance. These actions are expected to provide subordinates with an incentive to communicate truthfully, that can reduce budgetary slack [1]. In addition, to improve the budgeting process and make the budget more efficient, the companies need to check industry standards to narrow broad goals into specific business plans and metrics through iterative group discussion, and periodically reviewing the business by preparing monthly, bi-weekly, weekly, etc. budgets that are popular in business practice of many companies all over the world [2].

It goes without saying, that budgets play an important role in business organizations. They help to adapt quickly as the financial situation changes, and achieve financial goals. The widespread prevalence of budgets in companies ranging from major multinational corporations to small local businesses indicates that the advantages of budgeting systems outweigh the costs. To gain the benefits of budgeting, the management of all levels of the company should understand and support the budget and all aspects of the management control system. Without a budget, a business runs the risk of spending more money than it is taking in or, conversely, not spending enough money to grow the business and compete. Ultimately, many strategies are getting unsuccessful or remain unrealized at all.

#### Literature:

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The article demonstrates primary steps of the budgeting process. It indicates the importance of budgets in preventing unfavorable outcomes for the business organization. The advantages of budgets are identified and the master budget interrelationships are shown. The ways of improving budgeting process are offered.

Keywords: *budgeting, master budget, management, strategy, budgetary slack, improve*