

Minimal budgeting: the development of control mechanisms for small and micro e-businesses

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1. Overview of project

An important feature of approaches to performance management is the alignment of organisational objectives, measures of performance, and strategic decision making towards the promotion of value creation within the business. However, there is clear evidence that e-businesses differ from traditional businesses in many ways and that the prevailing wisdom regarding operational control through traditional methods of budgeting does not apply here. Some would argue that this is a root cause of the failure of many e-businesses while others would argue that this is the reason for their success.

We initially intended to identify those businesses that were entirely internet based and had no 'bricks and mortar' outlets. This proved to be both very difficult and impractical in terms of both gaining access and identifying any meaningful outcomes. We therefore widened our sample to include businesses that operate predominantly on the web. In this project we are now defining e-businesses as those organisations which do at least a considerable proportion of their business online, whilst possibly still maintaining a 'bricks and mortar' wing. The sample undertaken consists of either micro businesses (less than ten employees) or small businesses (ten to fifty employees). The aim of the research undertaken by the authors is to understand the framework for budgetary control (if any) which operates in this e-business environment. The uncertainty in this environment stems from a number of issues. For instance, the extent to which customers have access to the internet, feel confident with the technology, and are able to find and access the website. The skills of the salesperson are considerably altered in the e-business environment. There are uncertainties relating to the software such as downtime, user-friendliness and speed of access. There are also the uncertainties relating to a whole raft of issues in the area of internet security.

2. Research methodology

To ascertain the approaches to budgeting taken by e-businesses we conducted a screening exercise of e-businesses in an attempt to identify a profile of their budgetary control systems. To conduct this screening exercise we have made use of the CAM-I diagnostic test developed by the Beyond Budgeting Round Table (BBRT). This has provided an insight into some of the problems of control which are faced by these organisations and the range of solutions adopted, together with their levels of success. The e-business environment that we researched is fast moving and uncertain. Cash control is an important factor of budgetary control and there is a need for the trade-off between control and uncertainty. We also explored to what extent other traditional control systems are used. To understand this environment the relationship between financial and non-financial forms of control needs to be explored in the context of the other recognised functions of budgeting.

It was important to distinguish between the uncertainties of the environment in general and the expected additional uncertainty caused by operating in an e-commerce environment, and to be able to focus upon the latter. One of the major uncertainties of the e-commerce environment was reflected by the less traditional use of budgeting, reflected in such things as a less formalised budgetary control structure and frequent revisions to such budgeting as does exist, as well as in the more behavioural approach taken to the use of budgeting. Thus the behavioural aspects of budgetary control found so prevalent in the sample, in particular in small businesses, are focused less upon traditional management accounting control systems, through a precise allocation of responsibilities, and more upon either the owner keeping total control or that of fostering co-ordination, co-operation, and in some instances attempting to sustain long-term value (rather than short-term results) and flexibility. It is these aspects of the use of a minimal approach to budgeting which we considered to be the distinguishing features of this environment.

3. Objectives

This research was intended to address three questions:

1. In what ways do e-businesses differ from traditional businesses in terms of their budgetary processes and what are the implications for operational control?
2. How do the financial and non-financial control mechanisms relate to each other and what effect does the uncertainty of the environment have upon such businesses?
3. What are the most important factors in successful operational control and how is it possible to measure and account for them?

4. Findings

The project was inspired by the argument put forward by Hope and Fraser (2003) that budgeting was fundamentally flawed and should be abandoned as a management tool in favour of a better alternative. It is a short but logical step to consider therefore in a new fast moving environment – such as represented by the e-business world – where this would be particularly true. We also considered that the nature of entrepreneurial managers in such an environment would be such that they would be less inclined to adopt those traditional management procedures associated with budgeting.

An initial screening exercise of e-businesses, using CAM-I diagnostic test developed by the BBRT, provided an insight into some of the problems of control which are faced by the target organisations. This initial survey showed us that micro organisations are not users of the traditional management accounting toolkit. The results show that within micro organisations there appears to be a complete absence of any formal budgetary procedures. Our evidence would seem to suggest that the act of rejecting budgets by micro organisations could be construed as a progressive step by the adherents of the beyond budgeting model, and in terms of the model they are half-way there. Alternatively, and more likely, our findings show that these organisations see no benefit from a formal budgeting system.

One purpose of this project was to attempt to develop a generic set of rules and a methodology for deciding upon control mechanisms (financial and non-financial) for e-businesses. It also attempted to relate and measure the outcomes with particular respect to the trade-offs between uncertainty, operational control, financial control and the behavioural aspects of budgeting. This research is novel in that it aims to identify the issues which are essential for e-business managers and their management accounting colleagues. This will help to ensure a proper balance between control and flexibility, whilst providing suitable techniques for measuring outcomes. Thus our initial screening was extended through in-depth interviews. What we found was that entrepreneurship was considered to obviate the need for financial control in micro organisations, which was found to be true in all of the micro organisations researched.

For small organisations the situation was different as all organisations used budgetary control procedures. Control was firmly exercised by the owner managers – in a very traditional manner which was unrelated to the environment. Our sample was therefore completely bifurcated with micro organisations being completely informal in their use of control procedures, while small organisations were entirely traditional in their control. These results are surprising, especially as there seems to be no middle ground and no evidence of migration from one view to the other.

In the main, the information gathering through the interviews supports our findings from the survey, but some interesting additional data was also gathered. For example, all of the micro organisations in our sample do not use budgets and have only the most rudimentary systems of control. Significantly, they also have no plans for the future in terms of developing their businesses. There may be an element of luck in the development of such businesses, but we are reluctant to fully accept the implication of this interpretation of what we have learned. Since the research was completed at least one of the micro organisations has gone out of business. This particular business had not seen the need for even a basic break-even chart to identify the minimum number of monthly customers to survive.

We have identified a number of possible reasons for lack of growth in micro organisations.

The people whom we interviewed in micro organisations mainly run businesses which will probably not grow and develop beyond micro organisations, either through lack of ambition or lack of planning. Some micro businesses were unprofitable but the owners seemed unconcerned as they were simply enjoying the experience. Some said they were not prepared to sacrifice their business ethos for profitability and growth.

- This would imply that our sample was not as random as we hoped and that we have only interviewed people from the subset of businesses which will not grow. We have no reason to think that this is the case but the only way to test this of course is to observe the development – or lack of development – of these businesses over time.
- The nature of e-business is such that it attracts people who do not see planning of high importance, and they tend to be reactive rather than proactive. There is some evidence to infer this from the interviews and at least one case of a business, which had been forced to migrate into a wholly e-business. The entrepreneur interviewed stated that although she had migrated to a total e-business environment she still kept her shop because 'going to the shop was what she had always done'. Having said that, the type of businesses involved in the interviews was quite wide ranging and included both a range of service businesses (e.g. travel agents and various consultancies) and manufacturing businesses. It is difficult to believe that such a range of businesses had attracted the same personality types due to the nature of e-business.
- The informality applied to controls was applied to planning also. In other words, we are suggesting that plans only exist in these businesses in an informal manner. Thus the people who we interviewed were either unable or unwilling to articulate to us the plans that they had for the development of their businesses. Instead, they preferred to state that they had no plans for development.

5. Conclusions

Micro organisations

Our initial survey showed us that one should not expect micro organisations (less than ten employees) to be avid proponents of the traditional management accounting toolkit. Peer pressure does not exist within these organisations but, this does not preclude the use of stretch targets. Our evidence shows that within micro organisations there appears to be a complete absence of any formal budgetary procedures. This is consistent with much of the literature which highlights the fact that adhocracy rather than bureaucracy dictates the prevailing management approach. Further analysis is required to determine whether this attitude/approach is due to lack of confidence in the virtues of budgeting, or that staff simply do not have the time or the inclination to engage in the mechanics of the process. What they seek is adaptability and quality, more direct communication, openness and flexibility. An informal and intuitive approach is often adopted.

Our conclusion therefore is that there is a complete lack of budgetary control among the micro businesses examined but this is coupled with a lack of overt planning for growth. Such businesses rely entirely upon the owner-manager to manage the finances and it is unclear if the lack of budgeting is related to lack of desire for growth or merely mitigates against growth.

Small businesses

In contrast with this, our analysis suggests that in small businesses (ten to fifty employees) the owner-managers impose budgets which are rigidly adhered to and individuals are held accountable. The power of personality is used to impose control systems rather than through a formal budgeting system. Evidence showed that a major problem is that individuals are prevented from going beyond tight monetary restrictions often to the detriment of the business and causing a drop in motivation in the employees. This supports previous findings that employees are often denied the opportunity to stretch themselves beyond imposed financial constraining targets.

The standard answer, for the small businesses in our sample, about control from the owner is epitomised by the statement 'I maintain total control of everything that happens' which was repeated in nearly every interview with small business owners. Thus systems were often imposed via a top down approach and staff were rarely consulted before decisions were made. This highly authoritarian approach was partly explained by the need to maintain very tight control over both processes and costs in highly competitive markets. However, there is little evidence of development in these businesses and statements such as 'I took over the business from my father and have kept the business under my tight control' or 'I bought the business five years ago and have kept the same systems' express the operating ethos of these businesses. Within a number of these businesses the owners expressed the fact that the nature of the businesses meant that there were very few repetitive tasks or processes meaning that the imposition of standards became impossible, and from this perspective they had rejected the need for traditional budgeting systems beyond monitoring cash flow, and in a number of cases control systems were based on whether a job was completed within the quoted estimate (usually made by the entrepreneur) leaving a budgeted profit margin. There was little evidence of delegation or consultation.

Overall conclusions

Our findings have led to some surprising results in terms of answering our initial questions. It seems that e-businesses do not differ to any great extent from traditional businesses. The environment might be more uncertain but control is exercised exclusively by the owner manager. For micro businesses this meant a complete lack of any formal control procedures coupled with a complete absence of planning. Only 50% claimed to pay any attention to cash flow. While we do not believe that planning and control were completely absent; any that existed was so informal that the owners would not admit to it. We have suggested above several reasons why this might be the case.

The situation is completely different for small businesses in that control mechanisms were very formal and rigid, although planning was equally absent. The uncertainty of the environment seemed to make no difference; again we have suggested earlier why this might be the case. We have been forced to conclude that operational control is not considered to be significant by all micro business managers – a complete contrast to small business

managers – but that there is no link between control mechanisms and business growth, or even survival. Further study would be necessary to discover if this analysis is correct.

In terms of a generic set of rules, this has proved very difficult to establish from our sample. However, within both small and micro organisations it would appear that survival cannot be guaranteed through adhocery. Whilst detailed formal budgeting processes would not seem to be the norm, many of these organisations could benefit from more careful initial planning and regular cash flow monitoring. This could help to identify weaknesses and prompt the development of measures to ensure survival, even if growth is not on the agenda.

It seems that findings from this small but rich sample would reinforce the proposition that the beyond budgeting ethos is far from being a business model adopted by small and micro e-businesses, though our findings advocate a strong case for better budgeting in these organisations.

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