



The 6th International Scientific Conference
**“DEFENSE RESOURCES MANAGEMENT
IN THE 21st CENTURY”**
Braşov, December 02-03, 2011



BOTTOM-UP/TOP-DOWN BUDGETING

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Abstract:

For any organization, dealing with the budget is a great challenge. This article intends to present some aspects about two main types of budgeting: bottom-up and top-down, as they are used in many types of companies. From the beginning, there are said a few words about these methods, that are described after the introduction, one by one. For every method of budgeting, are shown the main advantages and disadvantages that were also detailed. At the end, this paper says some words as a conclusion for these budgeting methods. In an ideal context, the best way of budgeting could be a flexible mixture between the top-down budgeting and bottom-up process, for obtaining optimum results for the companies.

Key words: budget, budget preparation, bottom-up, top-down budgeting, resource allocation, costs.

1. Introduction

Generally speaking, a budget is a financial plan designed by organizations to describe future acquisition and the way of utilization of the resources. A business that operates without a budget definitely risks a financial failure because these budgets get along with managers in the planning and having under control the whole process. This context leads to efficiency in the process of spending the resources and effectiveness.

Budgeting is a process that plans the company's expenses and revenues for the future. Two of the most common techniques are top-down budgeting and bottom-up budgeting. In the top-down situation, upper management elaborates budgets without any input from employees or lower-level managers. In the bottom-up budgeting situation, employees and managers from department level elaborate budgets for their individual departments. The final budget of the organization is prepared from consolidating all individual budgets prepared by each department.

2. Bottom-Up Process

The bottom-up budgeting process begins with the basic components of an organization, generally at lower-level individual projects, to create in the end a collective budget for the organization. To start the bottom-up budgeting process, the responsible for the project ought to look at the main steps needed to carry out a complete project and associate a cost or a calculation to each step. Then, he has to perform market research to determine all the costs needed if he hasn't previously done the same kind of project within

The 6th International Scientific Conference
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his organization. Finally, he will need to sum the cost for each project in order to come up with the total budget. It is necessary to do this for each level of the structure or organization. The responsible will need the input of managers on every level, so that he is aware of the cost of all the projects. To come up with a complete annual budget, all he has to do is to sum up every monthly budget to obtain the entire budget for the year.

3. The Advantages of Bottom-Up Budgeting

Decentralized and Participative. Bottom-up process is a participative approach that allowed, at the budget preparation, input from organization managers and also employees. It utilizes their personal knowledge to formulate plans. The authors of the book "Interpreting Company Reports for Dummies" state that "bottom-up budgeting works better than the top-down approach because employees and managers take the budget preparation process seriously and are more likely to adhere to it once it is approved and implemented".

Greater Employee Motivation. Usage of bottom-up budgeting, by its decentralized and also participative nature, leads to increasing the motivation and involving employees. Employee motivation is directly related to job performance, higher morale, unit-level ownership, higher commitment and more satisfaction.

Suits Large Organizations. Bottom-up budgeting is a good method for large, complex and decentralized organizations where lower-level managers know a lot about customer behavior, main preferences, large scale of inputs, outputs and processes than top management. This budgeting method is more used in large organizations than the top-down approach, according to the authors of "Interpreting Company Reports for Dummies."

Accurate. Nils Rasmussen, in his book "Process Improvement for Effective Budgeting and Financial Reporting," states that "bottom-up budgets are accurate because they are prepared by employees and managers who are closest to the sources of revenue and have comprehensive expertise and knowledge that upper management lacks". Budgets are very precisely for each department and tasks. Also, resource predictions, detailed costs and product and sales forecasts are very correct. All individual department budgets are situated at a high level of quality.

Better Coordination and Communication. The authors of the book "Cost and Value Management in Projects" state that "bottom-up budgeting facilitates coordination and improved communication between functional department managers and upper management. Open lines of communication between top managers and functional managers exist, allowing top managers to communicate overall budget expectations and functional managers to report back any issues or problems". When we are talking about bottom-up budgeting, also understand that communication and coordination among managers employees and is encouraged in different organizational departments. Lower-level managers and employees ensure information and important feedback to functional managers about resources they are interested in and challenge them in their specialized areas.

BOTTOM-UP / TOP-DOWN BUDGETING

4. Disadvantages of the Bottom-Up Approach in Budgeting

Time Required. One of the main problems encountered to the bottom-up budgeting process is the amount of time it consumes. First of all, individual managers have to create their own budgets, taking into consideration past budgets and spending during the integration of cost projections for the next year. Then, upper-level managers and executives have to review all the budgets submitted by the managers, and also to sum them in order to find out totals. The next phase is the approval or feedback that requires recalculations, meaning that the whole process can repeat itself several times before a final form of a budget is approved.

Misrepresenting Budget Figures. In a bottom-up budgeting system, the managers who elaborate budgets know that will be asking for limited resources that other department budgets also need or wish to use it. In that case, managers tend to overestimate costs or pad their budget figures. On one hand, this can have a positive goal for specific department, this way being ensured the adequate amount of money available to accomplish its objectives; on the other hand, it can represent supersized budget figures and major overspending when a part of the managers pad department budgets by large amounts.

Lack of Expertise. In this form of budgeting, the responsible for budgets is likely to have enough experience in budgeting domain and some confidence working with financial resource allocation. However, a bottom-up approach required managers, who detain professional positions based on their specialized skills in specific fields, to perform the same administrative tasks as those that deals with this kind of skills. Even though there are managers who excellent motivate their teams and specialized in one particular field of business, they could not find cost savings and also estimate expenditures as well as someone else who work all day long with these figures or is higher in the organization.

Lack of Context. Bottom-up budgeting ask managers to elaborate budgets without the benefit of context within the company. Managers could have some information about other departments' activities but a bit amount of knowledge about main strategic goals and financial objectives for the organization overall. Instead, managers elaborate their budgets in separation or without guidelines from their top managers, working to ensure for own structures needs but missing out on what's best for the organization as an entity. Alternatively, when top executives mandate subordinates to prepare budgets in a top-down approach, each budget fits into a larger frame that accounts for all the organization's needs and resources.

5. Top-Down Process

Top-down budgeting is a planning system in which the budgeting process starts with a flow of information from the top of the organization down to the lower levels of the organization. This bunch of information generally includes an outline of overall goals for the year, specific guidelines for helping lower level managers to prepare their budgets, and templates to be fulfilled for submission of the budgets.

Even though bottom-up budgeting is more common, there are companies and governmental agencies that are renouncing to this method, replacing that with the top-down process. In this method, process of budgeting begins with an estimation of the cost, realized inside an organization for the higher-level tasks. In this case, the budgets are elaborated by management, and the other sides involved in this process (especially lower-level staff) do not have the opportunity to contribute in an efficient manner.

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The top-down method of budgeting presumes, from the beginning, that top management has a precise vision for the direction the organization should go in order to accomplish its objectives and become more successful. Lower level managers, depending on their division's or department's responsibilities, may have a limited view of the process. Top management also has, at the same time, a clear image of the resources that are available.

In the top-down system, the responsible structure prepares templates and instructions for the other departments or divisions to be fulfilled in budgets building. The overall organization goals for the next year are also communicated. The managers need to take these goals into consideration during their budgets preparation. For example, if a company decides to have a hiring freeze, this means that no new employees will be admitted in the next year. Department or division level managers are required to determine how to reach the proposed objectives utilizing the existing number of employees.

Once the departmental and divisional heads fulfill their budgets, the information flows upside, and they transmit their numbers and calculations to the finance department for integrating into one master budget for the entire organization. The finance department examines each budget row by row and determines whether there are some items that don't seem reasonable, or could be necessary clarification. In some companies, it is possible that finance personnel meet each manager and recommend changing the budget if this is necessary. In other organizations this review process is assigned to senior management. In this case, finance department plays the role of emphasizing main issues in each budget about the senior managers will discuss with the department or division managers. At the end of discussion and negotiation at top level, the division/department budgets and also the overall organization budget are submitted and approved by senior management.

6. Advantages and Disadvantages of Top-Down Budgeting

Efficiency. Traditional way for bottom-up budgeting implies that project managers allocate resources and budgets to each stage of the project. This could be an efficient process, but it could also be somewhat ineffective. Allocating budget and resources, from the beginning, for the tasks at a high-level, determine more effective usage of those resources. This situation could be observed in a smaller overall budget and also in better results.

Cost Control. In the top-down budgeting approach, money is allocated at the beginning for the tasks from the top-level in the major project and, after that, to the lower-level tasks. This pattern could help project managers and company executives to assign in a better manner their restricted resources and manage their costs in an effective way.

Need for Expertise. For this method, experience is mandatory. If the members of management team and project managers are not sufficiently trained and their expertise with top-down budgeting is low, they could not be able to properly allocate funds for every project. Using top-down budget approach presumes a wide range of experience, knowledge and ability to accomplish that situation; without this, the resulting project could be either underfunded or, sometimes, overfunded.

Process Difficulties. If there is a situation when the project manager does not find the correct solution for funding lower-level tasks, the worker responsible for those tasks can find themselves in a difficult position in order to accomplish proposed tasks related by the necessary resources. This situation could conduct to bad feelings, overflow the cost and delays in development of the project. One of the situation that can not be neglected is when

BOTTOM-UP / TOP-DOWN BUDGETING

some tasks, apparently minor, but important, could not get the resources that they are looking for. If that happens, the whole project could be put into danger. One of the solutions of this problem could be that top management takes into consideration the concerns of the lower level managers.

7. Conclusion

For an organization, in time and taking into consideration the taut of the top management and the main goals, the process of constructing the budget could be either the top-down approach, where top level managers establish the main rules to elaborate the budget, or the bottom-up approach, where top managers implies in construction of the budget personnel from lower-level department.

Reconciling a budget helps to demonstrate solid organizational objectives and priorities. The budgeting process can be different from organization to organization and from one period to another period. An organization may choose to approach budgeting from the bottom up, which means, in fact, that each line item issue is considered without taking into consideration the connection with the overall budget. This process differs from the top-down approach, which directs funds to departments and functions based on previous and expected needs. Ideally, these separate methods should reconcile to demonstrate diligent preparation and consistent priorities in the budgeting process.

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