

“Causal-Based Budgeting: Redefining the Future of Financial Planning”



“Do not save what is left after spending; instead, spend what is left after saving,” Warren Buffett

Introduction

Budgeting has long been regarded as the cornerstone of financial planning and control. For decades, organizations have relied on various budgeting approaches—incremental, zero-based, activity-based, and rolling forecasts—to estimate resources, allocate funds, and monitor performance. While these approaches have served as effective tools in a relatively stable business environment, today’s dynamic and uncertain marketplace calls for a more agile and insightful method.

The increasing complexity of business drivers—ranging from digital disruption, globalization, and regulatory shifts to consumer behaviour and sustainability demands—has exposed the shortcomings of traditional budgeting. Static numbers often fail to reflect the underlying drivers of performance, leaving organizations unable to anticipate disruptions or respond quickly to changes.

It is in this context that **Causal-Based Budgeting (CBB)** emerges as a transformative approach. By focusing on cause-and-effect relationships between resources, activities, and outcomes, CBB redefines budgeting from a static cost-control exercise into a dynamic tool for strategic decision-making. This article explores the foundations, framework, advantages, and challenges of CBB, while positioning Cost and Management Accountants (CMAs) as key enablers of this redefined approach.

Traditional Budgeting Approaches and Their Limitations

1. Incremental Budgeting

Incremental budgeting builds upon the previous year’s budget by making adjustments for inflation, growth, or strategic shifts. Its simplicity makes it widely used, but it perpetuates inefficiencies, entrenches past practices, and discourages innovation.



2. Zero-Based Budgeting (ZBB)

ZBB requires managers to justify all expenditures from scratch, rather than relying on historical figures. While it encourages cost consciousness, it is highly resource-intensive and often results in excessive focus on cost-cutting rather than long-term value creation.

3. Activity-Based Budgeting (ABB)

ABB extends activity-based costing by budgeting resources based on forecasted activities. Though it better reflects operational realities, ABB still struggles to adapt quickly to dynamic market shifts and lacks predictive power.

4. Rolling Forecasts

Rolling forecasts attempt to overcome rigidity by updating projections periodically (e.g., quarterly or monthly). While they improve adaptability, they often remain tied to financial figures without adequately reflecting the causal drivers that shape outcomes.

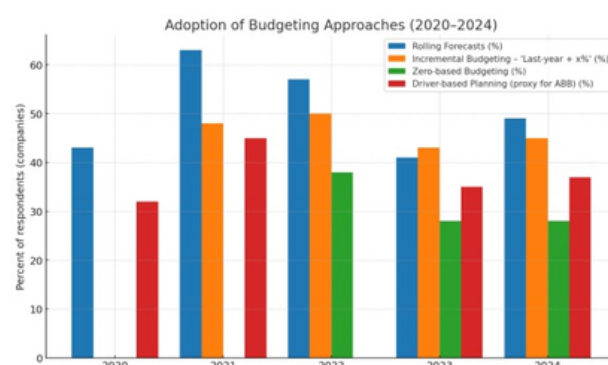
Common Limitations Across Traditional Approaches:

- **Rigidity:** Budgets quickly become outdated in volatile conditions.

- **Cost-Centric:** Emphasis remains on expenditure control rather than value creation.
- **Short-Term Bias:** Often focused on annual cycles, ignoring long-term drivers.
- **Misalignment:** Numbers may not truly reflect the strategic priorities or operational realities of the organization.

These limitations make a compelling case for a paradigm shift in budgeting—one that recognizes and leverages the causal relationships driving organizational performance.

Statistical Trends regarding the adoption of various traditional approaches by the Companies



(Date Source: FP&A Trends Survey 2021, 2024)

- **Rolling forecasts (% of companies using):**

• 2020: 43%, 2021: 63%, 2022: 57%, 2023: 41%, 2024: 49%. **(Data Source: FP&A Trends Survey 2021)**

- **Incremental budgeting ("last-year + x%" still used to set budgets):**

2021: 48%, 2022: 50%, 2023: 43%, 2024: 45%. (2020 not reported in public summary.)

- **Zero-based budgeting (ZBB) adoption:**

2022: 38% (successful implementations); 2023: “about the same” as 2024; 2024: 28%. (No public 2020–2021 % in the same series. **(Data Source: FP&A Trends Survey 2024)**)

- **Activity-Based Budgeting (ABB):**

· very rarely tracked directly in recent global surveys. The closest, consistently reported metric is Driver-Based Planning (methodologically similar, activity/driver-focused): 2020: 32%, 2021: 45%, 2023: 35%, 2024: 37%. (2022 overall % not explicitly reported **(Data Source: FP&A Trends Survey 2021& 2024)**)

Emergence of Causal-Based Budgeting (CBB)

Causal-Based Budgeting (CBB) is a budgeting methodology built on the principle of identifying, quantifying, and managing the causal factors that drive financial outcomes. Instead of merely projecting revenues and expenses, CBB focuses on linking operational drivers—such as production volume, workforce efficiency, machine downtime, marketing effectiveness, or customer acquisition rates—to financial performance.

Unlike ZBB, which emphasizes justification of costs, or ABB, which ties costs to activities, CBB emphasizes **cause-and-effect chains**. For instance:

- Increased advertising spends (cause) → Higher customer acquisition (effect) → Increased revenue.
- Machine downtime (cause) → Lower production volume (effect) → Higher per-unit cost.

This shift transforms budgeting from a backward-looking financial exercise into a forward-looking strategic model.

Framework of Causal-Based Budgeting

Implementing CBB requires a structured framework that integrates both financial acumen and analytical capability:



1. Identify Key Business Drivers

The first step is to identify the causal drivers that directly impact performance. These may vary across industries:

- Manufacturing: machine efficiency, raw material yield, labour productivity.
- Retail: footfall, conversion rates, basket size.
- Services: billable hours, client retention, service quality metrics.



2. Establish Relationships Between Drivers and Outcomes

Organizations must map the cause-and-effect relationships between drivers and results. This can be achieved through correlation analysis, regression modelling, or managerial judgment.

3. Build Predictive Models

With the relationships established, predictive models are developed to forecast how changes in drivers influence financial outcomes. Modern tools, including AI and machine learning, enhance accuracy and adaptability.

4. Integrate into Financial Planning

Causal insights must be embedded into budgeting and planning cycles. Instead of budgeting sales revenue directly, companies budget demand drivers and use causal models to derive revenue figures.

5. Continuous Monitoring and Refinement

Drivers evolve with market conditions. Regular monitoring and recalibration of models ensure the budgeting process remains relevant and dynamic.

Role of Technology

Enterprise Resource Planning (ERP) systems, business intelligence platforms, and advanced analytics are vital enablers. They automate data collection, provide real-time insights, and support scenario planning based on causal factors.

Strategic Advantages of CBB

1. Dynamic and Adaptive

CBB allows budgets to adapt in real-time as causal drivers shift. This makes organizations more resilient in volatile markets.

2. Alignment with Strategy

By focusing on value drivers, CBB ensures that budgets are aligned with long-term strategic priorities rather than short-term cost constraints.



3. Enhanced Decision-Making

CBB supports “what-if” analysis. Managers can simulate the impact of changes in drivers—such as pricing strategy or supply chain disruption—before making decisions.

4. Transparency and Accountability

By making causal chains explicit, CBB enhances clarity. Managers understand how their decisions impact outcomes, fostering accountability.

5. Improved Cost Management and Value Creation

Instead of cutting costs indiscriminately, CBB identifies levers that genuinely enhance value. For example, investing in preventive maintenance may reduce machine downtime, thereby lowering overall production cost.

6. Live Examples:

***FMCG Company:** By linking advertising spend to sales growth, a consumer goods company optimized its marketing budget, reallocating funds to high-impact channels.

***Manufacturing Firm:** A firm reduced unit costs by identifying machine downtime as a key causal driver and investing in predictive maintenance.

*** IT Services Provider:** By modelling client retention as a causal driver of revenue, an IT firm shifted focus from aggressive acquisition to customer satisfaction, boosting profitability.

Challenges and Implementation Issues

Despite its advantages, CBB is not without challenges:

*** Data Quality and Availability:** Causal modelling depends on reliable, granular data, which may not always be available.

***Complexity:** Identifying true causal relationships requires statistical rigor and domain expertise. Spurious correlations can mislead decision-making.

***Resistance to Change:** Shifting from traditional budgeting to a driver-based approach may face cultural resistance.

***Skill Gaps:** Finance professionals may lack expertise in advanced analytics, necessitating training and upskilling.

***Technology Dependence:** CBB requires strong IT infrastructure, making it resource-intensive for smaller organizations.

Role of CMAs in Driving CBB

Cost and Management Accountants are uniquely positioned to champion CBB because of their expertise in cost drivers, resource optimization, and strategic financial management. Their evolving role moves beyond accountants to strategists and advisors.

*** Understanding Cost Drivers:** CMAs are trained to analyse the link between resources, activities, and outputs—an essential foundation for CBB.

*** Cross-Functional Leadership:** CMAs can collaborate with operations, marketing, and IT teams to identify drivers and develop integrated models.

*** Performance Management:** By aligning causal drivers with KPIs, CMAs ensure organizational performance is tracked and managed effectively.

*** Ethics and Governance:** CMAs ensure that causal models are transparent, ethical, and compliant with reporting standards.

*** Change Agents:** By advocating for technology adoption and data-driven decision-making, CMAs can lead the cultural transformation required for CBB.





The budgeting process is undergoing a fundamental redefinition. In an era where agility, data, and strategy converge, **Causal-Based Budgeting** stands out as a forward-looking methodology that transcends the limitations of traditional approaches. By linking cause-and-effect drivers to financial outcomes, CBB transforms budgeting into a dynamic, strategic, and value-focused exercise.

For CMAs, the rise of CBB presents a unique opportunity. By leveraging their expertise in cost management, strategic planning, and performance evaluation, CMAs can position themselves as pivotal drivers of this transformation. The future of budgeting is not about controlling numbers—it is about understanding the causes that shape them.

As organizations strive for resilience, agility, and sustainable growth, Causal-Based Budgeting is not merely a financial tool—it is a strategic imperative. CMAs must embrace and champion this redefined approach, ensuring that budgeting evolves into a compass for navigating the uncertainties of the modern business landscape.



*Management Control Systems by Anthony, R.N.& Govindarajan, V. (2007) ,12th ed. New York: McGraw-Hill Education

*Driver-Based Planning and Budgeting. Chartered Institute of Management Accountants. (CIMA 2020) Available at: www.cimaglobal.com

*"Is the Annual Budget Really Dead?" European Accounting Review, 9(4), pp. 519–539. By Ekholm, B& Wallin, J (2000)

*Hansen, S.C., Otley, D.T. & Van der Stede, W.A. (2003). "Practice Developments in Budgeting: An Overview and Research Perspective." Journal of Management Accounting Research.

*Kaplan, R.S. & Cooper, R. (1998). Cost & Effect: Using Integrated Cost Systems to Drive Profitability and Performance. Boston: Harvard Business School Press.

*PwC (2021). Future of Finance: The Rise of Driver-Based Planning. PricewaterhouseCoopers Report. Available at: www.pwc.com.

*"Driver-based planning "at Planful.com Blog

*<https://images.app.goo.gl/GuZGCA5inuQLYogK7>

*Statistical Date Source: FP&A Trends Survey 2021, 2024)



CMA CS Shukla Bansal

FCMA, FCS, MCOM, POSH
Trainer& Consultant
Practising Company Secretary
Email: shuklabansal@yahoo.com