Examining the Behavioural Aspects of Budgeting with particular emphasis on Public Sector/Service Budgets

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Abstract

Budgets are part of management control designed to promote the efficient use of resources and providing support for other critical functions. The extent to which any budget is successful is very much dependant on its acceptance and the attitudes of workers towards it. This paper focuses on the crucial role of the behavioural aspects of budgeting and how an understanding of its importance can contribute to a successful budgeting process. It describes the nature of budgeting and analyses the budgeting process in organisations. The paper shows why budgeting is important to firms and describes the impact budgeting has on human behaviour such as motivation and dysfunctional behaviour. The behavioural aspects of the budgeting process are also examined. Finally, the public sector budgeting process is analysed, focussing on the need to tackle Beyond Budgeting issues in the 21st century whereby organisations budget without a budget. In the literature review, it was found that there was no perfect means of ensuring a successful budgeting process but there was general agreement in many areas of how the process might successfully assist. As with most concepts, there were mixed opinions on some issues such as benefits of participation as opposed to non-participation. What was common is the view that the budgeting process in particular and management control systems in general cannot afford to ignore the impact of behaviour on these processes.

Key words: Beyond Budgeting; behavioural aspects; budget and human behaviour; budgeting process; and public sector/service budgets

The Nature of Budgeting

Almost every enterprise, regardless of size, complexity or sector, relies heavily on budgets and budgetary systems to achieve strategic goals. The success and importance of budgeting relates to the identification of organisational goals, allocation of responsibilities for achieving these goals, and consequently its execution (Shah 2007; Robinson 2007; Drake and Fabozzi 2010). It is one of the most successful and useful management accounting techniques that can reap handsome rewards if properly understood and implemented.

The process of budgeting involves setting strategic goals and objectives and developing forecasts for revenues, costs, production, cash flows and other important factors (Jr. Bierman 2010; and Bonner 2008). By putting together a financing and investment strategy in place, this will allow those responsible for financing of the company to determine what investment can be made and how these investments will be financed. "*In other words, budgeting pulls together decisions regarding capital budgeting, capital structure, and working capital*." (Drake and Fabozzi 2010: 115). The end result of the process is the production of the formal document referred to as a "budget".

According to Campbell (1985), a budget is a quantitative analysis prior to a defined period of time, of a policy to be pursued for that period to attain a given objective. Its main purpose is to aid in the achievement of objectives and direct managerial effort (through planning, co-ordinating, measuring and rewarding) throughout the organization towards global purpose. Like Campbell (1985), other writers such as Drake and Fabozzi (2010), Bonner (2008), Jr. Bierman (2010), and Miller *et al* (2001) have all agreed that budgeting is mapping out the sources and uses of funds for future periods.

However, it is believed that there are both technical and behavioural aspects to budgeting that can benefit all firms if properly understood and co–ordinated. Although the technical aspect is always emphasized as being most important, Campbell (1985) indicates that the recognition of both the technical and behavioural aspects of budgeting is essential, if goal and behaviour congruence[1] are to be achieved. Recognising this dimension, Hope & Fraser (2001), Morris *et al* (2006), Boon *et al* (2007) and other writers in the field are now focusing on the organisational and behavioural changes needed to support the budgeting process. This is reflected in the latest set of twelve Beyond Budgeting principles, which entails a shift from financial performance emphasis to one based on people.

The technical component of budgeting deals with a mathematical computation of projected costs and expenses and has been heavily emphasised in the public sector. The behavioural component however focuses on the ability to achieve the technical aspect of budgeting with the use of people. Having observed the nature of the budgeting process Hopwood (1974), Redman and Wilkinson (2009), Boxall and Purcell (2008) and Eamets *et al* (2008) argues that behavioural and social aspects are an integral part of the budgeting process and should not be divorced from the technical side.

As such, organisations should recognise that the effective use and application of any budget is very much dependant on the extent to which employees are committed to the ideals of the budgetary process and encourage behaviour that is in accordance with the entity's objectives. Bratton and Gold (2007: 442) assert that an organisation can build capacity through employee participation and empowerment.

The Need for Budgets

Budgets are formalized plans of management's objectives. They serve as a guide in the implementation of a selected strategy but during the budget period it acts as a management control device. The following are some of the different roles played by budgets, which provide a platform for dealing with management related functions.

Systematic Planning

Budgeting process provides a framework for implementing major strategic decisions and ensures that limited and precious resources are efficiently and effectively allocated in order to achieve specific measurable targets.

Co-ordination and Communication

The budgeting process fosters coordination, cooperation and communication among the various business units. It promotes dialogue and understanding by linking various departments together thus ensuring that attainment of overall objectives. Budgets can also act as an instrument to remind everyone of the agreed targets and to measure progress to date.

Quantification and Cost Awareness

The budget seeks to achieve optimal resource allocation and as such, cost awareness and quantification of benefits become relevant. It is relatively straightforward to estimate costs but the challenge lies in accurately quantifying the benefits to be derived.

Control and Evaluation

A comparison of actual results against budgeted projections provides a basis for evaluating performance and signals the need for corrective action. This comparison can be very meaningful since it identifies the variances, which need analysis and investigation.

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[1] Goal and behaviour congruence exists when the goals of the manager or worker are in accordance with the goals of the organisation.

Motivation

Motivation can be referred to as the fuel that drives employees to achieve strategic goals and the resultant force that influences action towards such goals (Shah 2007; Robinson 2007; and Rubin 2010). Obtaining goal congruence is essentially a behavioural issue. Involvement in the budgeting process is therefore of significant importance because budgets serve to motivate employees and managers by giving them a sense of purpose. Where rewards are attached to the attainment of budget standards it serves to act as a motivator. According to Parker (cited by Banham, 2000) Fujitsu's system of linking 40% of managers' compensation to successful execution of departmental plans and budgets motivates them.

Budgets and Human Behaviour

The success of organizational control depends upon the actions of top management and their appreciation of the importance of sound interpersonal relationships between different levels of the hierarchy. Management accountants through the budget process can motivate employees and improve attitudes amongst managers towards budgetary control. The reward gained on achieving the required budget level is important for motivating lower level managers and employees (Otley 1977; Shah 2007; and Robinson 2007). Consequently, the management style, culture and attitude towards employees will determine the approach to budgeting within the organization.

There are three main approaches that can be employed in developing data for the final budgets. These are the:

- **imposed (top-down) budget-** This type of budget is supportive of the autocratic style of leadership where top management alone decides on the budget and lower level management is only responsible for the execution. According to Boon et al 2007; Boxall and Purcell 2008; Morris et al 2006; Jr. Bierman 2010 and Shah 2007, this approach reduces decision making time.
- **participative (bottom-up) budget-** This type of budget is supportive of the democratic style of leadership where lower level management is empowered through their contribution to the budget.
- **negotiated budget-** This type of budget adopts both the imposed and participative styles of budgeting and creates an environment where there is shared responsibility for budget preparation.

The approach chosen would to a large extent depend on the leadership style and the nature of the organization (Glautier and Underdown 1994; Redman and Wilkinson 2009; Bar-Haim 2002; Bratton and Gold 2007; Boxall and Purcell 2008; and Sagie and Koslowsky 2007). It is widely felt that budget systems developed using the participative or negotiated approaches would elicit greater support from workers and managers (Robinson 2007; Bonner 2008). Simply engaging under the pretext pseudo-participation or consulting with managers or workers prior to establishing the budgetary goals is not participation. Argyris (1952) has criticised many schemes for not offering any real participation and as such, contribute little or no value.

Hofstede (1968) articulated that budget participation should create a positive "game spirit" in all its aspects – system design, target level setting, analysis of budget variances, and corrective action. Other researchers (Hopwood, 1976, Otley, 1978) have discovered that the impact of budgets on job related behaviour depends more on the style in which the budget is used than on its technical design (Rubin 2010; Shah 2007; Boon *et al* 2007).

According to French (1966) the effect of participation is conditional upon personality, organizational culture and history. Therefore, the effectiveness of any management control systems is dependent on the extent to which it influences human behaviour in the firm's best interest. McGregor sought to characterize management styles and attitudes into two extremes; Theory X and Theory Y. Theory X is based on the assumptions derived from scientific management and the early theories of motivation by Mc Gregor, F.W. Taylor and Gilbreth (cited from Campbell, 1985). They saw the worker as being motivated mainly by money and unable to contribute meaningfully to the decision making process of the organization (Boxall and Purcell 2008; Bratton and Gold 2007; and Redman and Wilkinson 2009). Conversely, a worker motivated by the possibility of promotion or job security is classed as Theory Y.

While this authoritarian method might produce results it creates frustration and is an impediment to the personal development of employees (Kaplan, 1971, cited by Campbell, 1985). More so, employees are not personally committed to the budget accomplishment, as such will seek out ways and means of circumventing the budget process.

Organisational theory also provides a framework for understanding the influences, which bear upon organisations. The classical theory is concerned with the structure of the organisation and the determination of tasks necessary to attain organisational objectives. By contrast, the human relations approach[2] stresses people rather than structures, their motives and behaviour rather than the activities, which need to be harnessed for achieving organisational goals. It asserts that the most important factors are individual needs and wants, the structure of organisations should be geared to individuals rather the individual being geared to the structure (Glautier & Underdown, 1994).

Modern theories of organisational behaviour (McGregor Theory X and Y, Hertzberg Hygiene Factors) recognize diversity in human behaviour[3]. McGregor (1960) claimed that employees who participate in the process are more likely to internalize the goals of the budget resulting in: a higher response level since they contributed to the development process and greater efficiency in the planning process. In addition, this leads to higher employee levels of performance, morale and the opportunity to satisfy higher level needs.

Modern writers claim that budgets motivate[4] best if they are challenging (Etherington & Tjosvold, 1992). One of the contemporary approaches to motivation is known as Expectancy Theory, which relates to choice behaviour. Vroom (1960) in formulating the theory contends that individuals will evaluate various strategies of behaviour and deliberately choose the one they believe will lead to those work related outcomes that they value.

Rockness (cited by Fyfe, 1994) in attempting to show the relevance of expectancy theory to budgeting claimed that a budget that was difficult to attain coerced a superior effort from employees to one that was moderately difficult. The implication of such is that management can influence the level of motivation of subordinates towards successful budget attainment by external rewards.

Hertzberg (cited by Hirsh and Louderback, 1990) two-factor theory of motivation has been widely applied by managers concerned with the motivation of employees. Hertzberg claimed that there are two distinct types of motivational factors: satisfiers (higher level needs) and dissatisfiers. The assumption of this theory is that merely satisfying one's needs do not act as a motivator. Hertzberg and McGregor (cited by Hirsh and Louderback, 1990) on the other hand argued that once workers have achieved lower level needs such as salaries, they seek to satisfy higher level needs such as recognition and self actualisation.

New considerations in the assessment of managerial behaviour have been inspired by protagonists of agency theory, which looks at the impact of discretionary managerial behaviour on management information. In this theory, basic assumptions about human behaviour in organisations are examined in terms of a principal and agent relationship. This theory is appropriate for addressing the problem of information hoarding[5]. The implication of these modern theories to budgeting is that meaningful participation in the budgeting process by lower level managers and supervisors draws them into the decision making process. With greater responsibilities and a voice in the control process, workers and subordinate managers are more likely to identify with the achievement of budgets.

Examining Behavioural Features of the Budgeting Process

The level of participation should be commensurate with the level of job difficulty. Studies have shown that participation was effective when both job difficulty and participation were high, but that participation was ineffective when job difficulty was low. When a job is easy, an imposed budget may be readily accepted, but this is highly unlikely to be the case in a difficult and uncertain environment (Kennedy, Dugdale 1999).

On the other hand while the participation chemistry may lead to acceptance and desirable behavioural responses (Morris et al 2006; Bratton and Gold 2007), the cost factor may far outweigh the benefits received since some managers may seize the opportunity to bias estimates or inflate the importance of their department in competing for resources. Thus it may be necessary for the firm to develop a cost benefit analysis and pursue ways of clearly communicating it while maintaining the participation mode.

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[2] This approach originated in the Hawthorne experiment of the 1920's, which revealed that social and human factors in work situations were often more important than physical factors in affecting productivity.

[3] These theories recognize that people care about the work they do and are motivated by factors other than money.

[4] Motivation is viewed as a multi-step process that incorporates the concept of needs, drives, goals and rewards and self-actualisation.

[5] Information hoarding is where employees hold private information and do not communicate it, or communicate only the information that it wants to communicate.

Participants in the budgetary process must be oriented as to its purpose and benefits in a total sense, while attempting to erase negative perceptions and minimise dysfunctional behaviour. Consequently, clear concise explanations of long-term organizational objectives within which the budget operates, must be communicated to budgetees. Hopwood and Horngren (cited CIMA Study Text, 1991) suggest that the multiple goals of an organization such as profitability, growth, customer service, product quality, employee welfare, contribution to community should be made known to employees. More so, performance feedback should be provided frequently as these contribute to higher performance.

There are mixed views on the relationship between commitment and the performance of employees in the budgetary process. Foran and DeCoster (1974) challenge the view that participation leads to commitment. This position is valid in an environment of mistrust, where attempts by top management to engender participation may be viewed suspiciously by subordinates. While Schiff and Lewin (1970) from their studies found that participative budgeting did not result in the optimal use of resources.

Conversely, Becker and Green (1962) contend that participation improves interaction and by extension group cohesiveness among employees. These ingredients they posit if positively correlated with incentives, can lead to higher or lower performance depending upon the environment or prevailing circumstances. Senior management in both private and public sector can offer support by using budgetary control information as a 'tool' for managers to use constructively, not as a way of apportioning blame and punishing managers who fail to achieve a target. From the public sector stand point, the validity of a national budget as an instrument of control, planning and decision-making raises many questions as the politicians seek political mileage (Rubin 2010).

An Overview of the Public Sector / Service Budget

Public sector/service budgets have the same characteristics as private sector budgets. The major difference is that the former is an instrument of governmental control and is not designed with a focus on profitability. The national budget is a plan for an entire population and is made up of a collection of budgets from within the public sector. According to Barsottti (cited, Fyfe 1994) it is a series of documents –

(1) a review of fiscal measures
(2) report on development programmes and
(3) review of the economy.

Within the public sector/service lower level managers are more likely to have an input in the budgeting process than their counter parts in the private sector, for example estimates of revenues and expenditures are proposed and submitted for discussion. Of the three approaches to budgeting, the negotiated system seems to be one that is operational in the public sector/service. This approach utilises the precise knowledge of lower level managers (accounting officers and ministerial heads of departments) with the broad perspectives of top-level management (Minister of Finance and Cabinet).

Consequently all agencies/bodies within each Ministry are required to make presentations of their estimates before the budget is finalized. Over the years the previous year's budget with its amendments is used as the benchmark to tailor the needs of the units referred to above. "Seasoned" managers who are aware of cut backs will inflate their agencies' cost. This practice of trimming budgets to meet revenue projections tends to be de-motivating and dysfunctional to its participants.

Another practice of public sector budgeting is the use of the National Budget as a political instrument (Rubin 2010; Shah 2007). The budget as a device for motivation does not only involve managers and workers at ministerial levels but its achievement impacts the population as a whole. As a political tool to motivate support for governmental objectives, public service budgets are consciously prepared with a high degree of bias. This raises questions on its validity as an instrument of control, planning and decision-making. It suggests that a major factor in its design is to mobilise public support for the existing political regime. The 2011-2012 National Budget of Trinidad and Tobago exemplifies this well. For instance, indicators such as no introduction of new taxes for ordinary citizens as well as corporations coupled with increased benefits payable to retired citizens reveal that these represent "*goodies*" intended to gain support. This is particularly important in understanding that one cannot satisfy the wishes of all stakeholders and interest groups all the time, and decisions must be taken with certain critical issues at hand (Bonner 2008).

Take for example, the National 2011-2012 budget of Trinidad and Tobago was met with mixed views by different stakeholders. Some line ministers articulated that more resources should have been directed to Health and the Works and Infrastructure ministries but not at the expense of other ministries. Additionally, the provisions made to bailout ordinary citizens who invested in CLICO and the Hindu Credit Union was met with mixed reactions. Among various interest groups, controversy arose over this bailout strategy.

Another feature of public sector budgeting in Trinidad and Tobago is the fact that performance evaluation does not appear to be a central part of the budget process. For example, various budget centres are evaluated on the basis of having overspent or under-spent budgets rather than on efficiency of operations. There seems to be no built-in incentive system to motivate agencies/bodies to achieve beyond their targets. Conversely, the evaluation of a manager's performance in terms of departmental budget is one of the few elements in performance appraisal, which is based on concrete standards. If budget pressure becomes too great it may lead to mistrust, hostility and eventually to poorer performance levels resulting in actions detrimental to the long-term prospects.

A dysfunctional practice associated with public sector/service budgeting is the "spend it or lose it syndrome" where agencies tend to engage in unnecessary spending to use up their full budget before the fiscal year ends because of fear of reduced allocation in the future.

In summary, Cassell (2000) described the public sector/service budget as very bureaucratic. According to him the following four key points emanate from this type of budget:

- Doubt reigns: managers begin calculating budgets two years ahead, but do not know how much of the previous budget they have spent until the current year of accounts are closed four to the six months into the following year.
- Budget controllers question unspent allocations and reduce the next year's budget by that amount – so departments inflate their estimates.
- Despite huge internal debate, budget decisions have to be made quickly. The ratio of decision-making time to budget preparation is ridiculous.
- The budget process is full of talk about prospective activities and accomplishments, but includes little on what has been achieved. Budget requests are based on how much that area got last year, there is no talk about whether the proposals in the previous budget produced results.

In short, public sector/service budgeting is a process of inputs rather than outputs. Too much time is spent debating and red tape makes it difficult for employees to do their work. Taxpayers suffer from these inefficiencies! Instead, the budget preparer should strategically link the spending priorities in the budget to the performance of the entire programme, rather than review each in isolation. According to Hope & Fraser (2001) research has shown that 60% of organisations do not link strategy and budgeting and 85% of management teams spend less than one hour per month discussing strategy. Hence, the US Government has reviewed its bureaucratic position and has responded accordingly, at a time when the Beyond Budgeting is expected to transform the way in which organizations budget without a budget.

Beyond Budgeting in the 21st Century

Traditional budgets hold companies back, restrict staff creativity and prevent them from responding to customers (Hope & Fraser, 2001). Beyond Budgeting argues that firms today need to be more flexible and responsive to deal with unpredictable change, hyper competition and increasingly fickle customers. Libby & Lindsay (2003) claimed that this requires more effective strategic management and the replacement of the command and control designs of most organisations with the dispersion of more authority to the front line.

Emerging from this, there has been widespread worker participation in management which has led to job enrichment and the enhancement of employees' motivation (Redman and Wilkinson, 2009). In some situations, legislation has informed the management process, research conducted provides insights, and advancement in technology radically changed how organisations manage, conduct business and communicate. These new best practices acted as a catalyst in fostering and propagating Beyond Budgeting.

In a 1998 CFO Europe survey, 88 % of respondents said that they were dissatisfied with the budgeting model (Banham, 1999).

Kaplan and Norton (2001) claimed that the value of budgeting has diminished and continues to add less value than expected, not withstanding the resources ploughed into this activity. Beyond budgeting is focusing on new steering mechanisms to replace budgeting where organizational and behavioural changes are needed to support these new mechanisms. This is reflected in the latest set of 12 Beyond Budgeting principles listed below (Hope & Fraser, 2001).

- Governance – use clear values and boundaries as a basis for action, not mission statements and plans.
- Performance responsibility – make managers responsible for competitive results, not for meeting the budget.
- Delegation – give people the freedom and ability to act, do not control and constraint them.
- Structure – organise around the networks and processes, not functions and departments.
- Co-ordination – co-ordinate cross company interactions through process design and fast information systems, not detailed actions through budgets.
- Leadership – challenge and coach people, don't command and control them.
- Goal setting – beat competitors, not budgets.
- Strategy processes – make the strategy process a continuous and inclusive process, not a top-down annual event.
- Anticipatory management – use anticipatory systems for managing strategy, not for making short-term corrections.
- Resource management – make resources available to operations when required at a fair cost, don't allocate them from the centre.
- Measurement and control – use a few key indicators to control the business, not a mass of detailed reports.
- Motivation and rewards –base rewards on a company and unit level competitive performance, not predetermined targets.

In essence, Beyond Budgeting entails a shift from a performance emphasis on numbers to one based on people and institutional arrangements. According to Shah (2007), this technique of Beyond Budgeting allows institutions to build a base of political support, achieve a more equitable distribution of scarce resources, foster public learning, and promote transparency.

Conclusion

Budgeting is a complex process, and the best results can only be achieved when a mix of factors is taken into account. The personalities of the participants, the type of budget being set (revenue or expense), the approach to performance reporting and the degree of uncertainty present are all important factors that cannot be overlooked. To incorporate all these factors successfully, requires a high level of sensitivity and excellent communication skills amongst accountants. Budgets do not possess the capacity of becoming effective performance and control tools nor is there an automatic outcome during this process. As worldwide events have a more dynamic impact on companies, and as product life cycles have shortened, budgets have become more inaccurate (Prendergast 2000; Miller et al 2001; Robinson 2007). Too often, organizations tend to expect results from budgetary control and fail to recognize that most problems of budgeting are behavioural. Where there is cause for dysfunctional behaviour, pressures are created leading to mistrust, hostility and actions detrimental to the long-term prospects of an organization. Thus, every budgeting system must be tailor-made and its success should be measured by the extent to which it provides the necessary motivation for individuals to make their maximum contribution to the achievement of organization goals.

Management accountants must recognize that accounting techniques and human relations are inextricable bound with each other. The behaviour aspects of budgeting are significant and the management accountant has a responsibility to minimize the behavioural problems within the accounting systems for control. It follows that management accountants should work more closely with behavioural scientists to gain an understanding of the essential role that human behaviour plays in successful budget use.

Beyond Budgeting has been mooted as a new steering mechanism to replace traditional budgeting. In essence, Beyond Budgeting entails a shift from financial performance measures to one based on people (Hope and Fraser 2001; Shah 2007; Rubin 2010). As such, this must be accredited as a new performance and evaluation mechanism for today's organisation.

Nonetheless, no matter what best practices are employed in the budgeting process in particular and the management control systems in general, one cannot afford to ignore the impact of behaviour on these processes.

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