

# Planning and budgeting: whence and whither

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# An ambivalent practice

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“... without planning events are left to chance”  
(Koontz & O'Donnell, 1972)

“Managers keep forgetting that it is what they do,  
not what they plan, that explains their success”  
(Weick, 1995)

# Why do firms plan?

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## Plans fulfil different purposes



Motivation, target setting, control



Coordination and resource allocation



External information

# Budgeting

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**Annual budgeting is the most frequent form of short-term financial planning**

- Budget defines profit, revenue, or cost **targets** for the various organizational units
- Resources (FTEs, investments) are **allocated** on the basis of these budget targets
- **Coordination** between units happens on the basis of budget numbers
- Budget becomes the reference point for performance **evaluation**
- Progress in achieving the budget is **monitored** during the year



# Research on budgeting

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## **Seminal studies in budgeting**

- Human problems with budgets
- The game of budget control
- Different leadership styles when using budgets
- Achievability of budget targets

# Research on budgeting

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## Human problems with budgets

- Argyris (1952, 1953) identifies different problems that the use of budgets brings about
  - Top management uses the budget as a pressure device
  - Budget pressure unites employees against management
  - Finance staff obtain feelings of “success” only by finding fault with faculty people
  - Factory supervisors focus on their own department only
  - Supervisors experience strong tension and sometimes frustration
- One recommendation from this study: front-line supervisors should participate in setting or changing budgets

# Research on budgeting

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## The game of budget control

- Hofstede (1968)
  - **Participation** as key for motivation, but also other factors that may limit the positive effect of participation: personality, culture, leadership practices, etc.
  - A **game-playing attitude**, where budget fulfilment is seen as a sport, increases motivation
    - “It is a game. We tighten up the proposed standards beforehand and then we drop some of it and so does the line manager. It’s quite passionate bargaining, but in a friendly way”.



# Research on budgeting

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## Different leadership styles of using budgets

- Hopwood (1972) observes different “styles” of using budgets for performance evaluation: budget-constrained, profit conscious, non-accounting
- Managers who feel that they are evaluated on the basis of a budget constrained style
  - report higher levels of **job-related tension**
  - report more **problematic relations with their supervisor** and peers
  - are more likely to engage in **manipulative behaviour**



# Research on budgeting

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## Achievability of budget targets



- Merchant and Manzoni (1989) examine budgets in 54 profit centers of 12 corporations
  - How achievable are budget targets?
  - Budget targets appear to be set at **highly achievable** levels (74% of profit centers achieved their targets)
  - Managers speak proudly of their ability to achieve targets consistently
  - Highly achievable budget targets have benefits for both PC managers and top management

# Research on budgeting

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## **Selected streams of literature following from these seminal studies**

- Participatory budgeting and misreporting
- Target setting and RPI
- “Innovative” planning practices
- Budgeting as a ritual

# Misreporting

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## Misreporting and budgetary targets



# Misreporting

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## Frequent gaming behaviors

Types of gaming behavior reported	Occasionally	Frequently
Negotiating easier targets (“budgetary slack”)	60%	26%
Spending money at year end to avoid losing it	57%	23%
Deferring necessary expenditures	52%	39%
Accelerating sales near year end to make the budget	41%	20%

Source: Libby and Lindsay (2010)

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# Misreporting

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## What determines subordinates' behaviour in a participatory budgeting setting?

- Agency theory predicts that subordinates create maximum amount of slack if they can (i.e. in a slack-inducing pay scheme).
- Early experiments (e.g. Young, 1985; Waller, 1988; Chow et al., 1988) find that subordinates create less slack than agency theory predicts (around 20% of the maximum possible slack, Brown et al. 2009). Reasons:
  - “Social pressure” (Young, 1985)
  - Desire to appear honest (Hannan et al. 2006)
  - General ethical norms (Stevens, 2002)
- Subordinates may frame a budget situation in different ways: as an ethical dilemma or as a matter of fairness (Ranking, Schwartz, Young 2008)
- Level of honesty is also driven by the financial/non-financial nature of the budget report and direct/indirect nature of benefits (Church et al., in press)

# Misreporting

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## Truth-inducing indicators in practice

Jordan & Messner (WP) examine the use of sales forecast accuracy as a performance measure within a manufacturing firm

- FA used as part of a tournament for distributors. But rather low motivational effects
  - Positive effects on e.g. lead time not visible to distributors
  - FA perceived as not very controllable.
  - Difficult to specify a good target level
- Over time, move from pure results control to input control.

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# Target setting and RPI

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## How do firms set targets?

- Managers' targets are based mostly on future planning information or past performance information, and less frequently on internal or external benchmarking information (Murphy, 2001; Dekker, Groot & Shoute, 2012).
- Evidence for target ratcheting (Leone & Rock, 2002; Bouwens & Kroos, 2011)
- Evidence for a “ratchet effect” (e.g. Bouwens & Kroos, 2011)
- But also evidence that firms commit to not use current performance versus target when setting future targets (Indjejikian et al., 2014): High-profitability managers versus low-profitability managers.

# Target setting and RPI

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## Relative Performance Information – three perspectives

**Economic theory** posits that RPI filters out common uncertainty from performance, thus improving its information value (Frederickson, 1992; Holmstrom, 1982).

- Example of a National Employment Agency that evaluates its Jobcenters (Goretzki et al., 2017):
  - Statistical analysis of what drives integration quota: economic, labor market, demographic variables
  - Clustering of Jobcenters with similar characteristics
  - Relative Performance Evaluation within the cluster

# Target setting and RPI

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## Relative Performance Information – three perspectives

**Social psychology theory** suggests that RPI encourages social comparisons among employees, which can have motivational and learning effects (Festinger, 1954; Frederickson, 1992; Hannan, Krishnan, & Newman, 2008; Hannan, McPhee, Newman, & Tafkov, 2013; Tafkov, 2013).

- Several studies find that providing information about performance ranks has a positive effect on employee effort and performance (e.g. Charness et al., 2014; Hannan et al., 2013; Tafkov, 2013).
- In repeated tournaments, top performers tend to become complacent while weak performers give up (e.g. Berger et al., 2013). These effects are stronger the stronger the performance differences are (Casas-Arce & Martínez-Jerez, 2009).

# Target setting and RPI

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## Relative Performance Information – three perspectives

**Sociological theory** highlights structural effects of rankings (e.g. Espeland & Sauder)

- Rankings induce a self-fulfilling prophecy (Espeland and Sauder, 2007)
  - Prospective students react to small, “artificial” differences, making these differences bigger.
  - Survey-nature of ranking leads to correlation over time (prior ranking shapes current evaluation)
  - Resources within universities are allocated on the basis of rankings → position in ranking decreases with less resources

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# “Innovative” planning practices

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## (How) do firms move away from traditional budgeting?

- Beyond Budgeting movement (Hope and Fraser, 2003)
- More dynamic forms of planning (use of rolling forecasts and relative performance evaluation)



# “Innovative” planning practices

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## Firms’ experiences with Beyond Budgeting ideas

- Becker (2014) compares budget abandonment in 4 firms in German-speaking countries. He finds that a move towards Beyond Budgeting ideas
  - typically goes along with a change in organization culture and is driven by key change actors (CEO, CFO)
  - may be undone when the organization faces financial distress and a new management comes in
- Henttu-Aho and Järvinen (2013) study changes to budgeting in 5 Finnish firms. They observe that:
  - budgets often first lose legitimacy as a planning instrument and are replaced by rolling forecasts, but still serve a target-setting function

# “Innovative” planning practices

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## How have Beyond Budgeting ideas developed over time?

- Becker, Messner, & Schäffer (WP)
  - Trace the development of Beyond Budgeting from the 1990s till today
  - Identify two different approaches to BB: idealistic and pragmatic

*“Beyond Budgeting **cannot be a ‘pick-and-mix’ approach to change. It is an alternative coherent model or it is nothing.**”*

*(Hope and Fraser)*

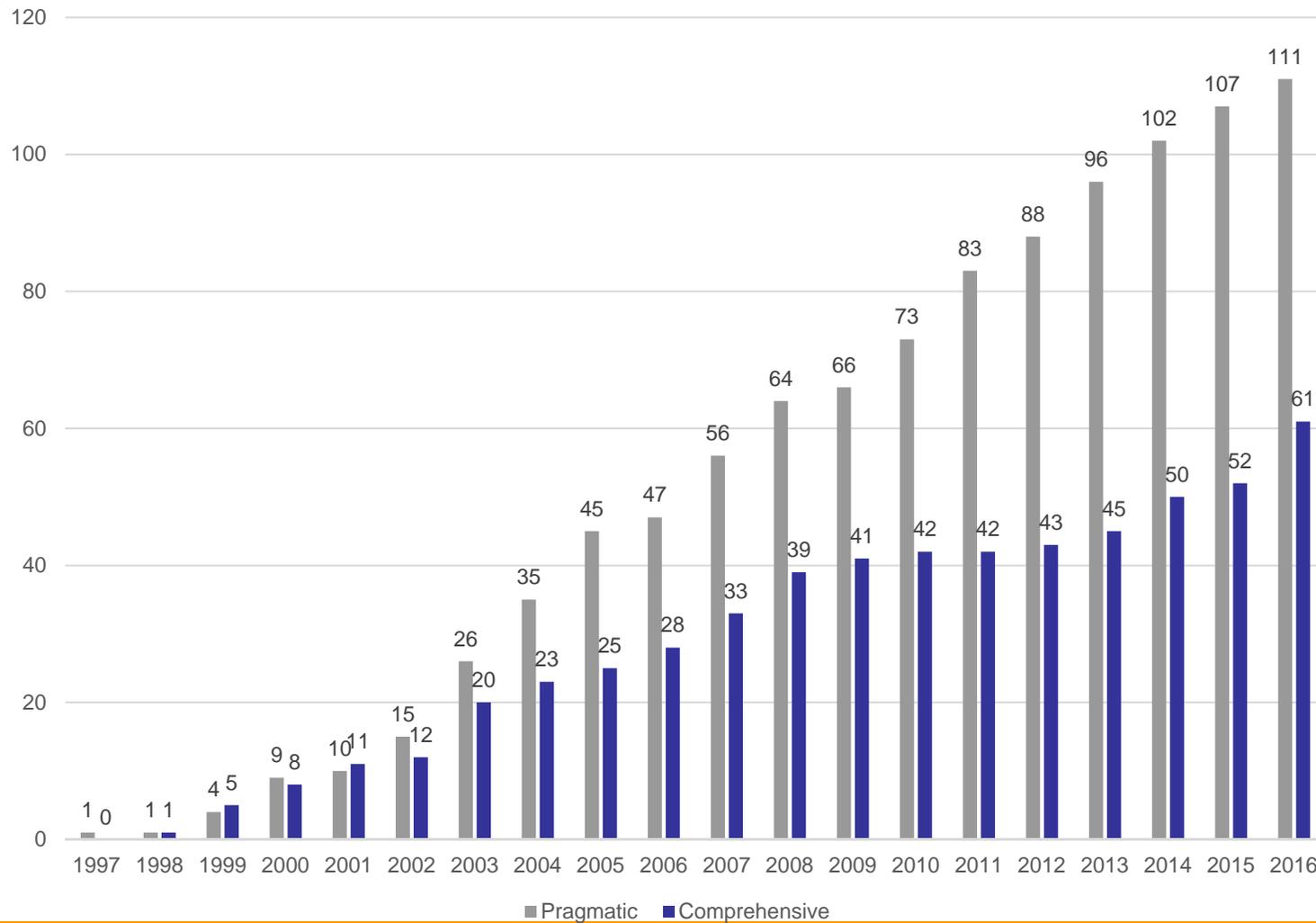
*“And I think Steve Player ... is **not throwing the budget away. He is taking account of the budget and relaxing some of the constraints of the budget to make it more flexible, more adaptable.**”*

*(Michel Lebas)*

- 4 phases in the evolution of Beyond Budgeting: Development of the idea through ongoing “boundary work” (Gieryn, 1983)

# “Innovative” planning practices

## Increasing dominance of “pragmatic” approach over time

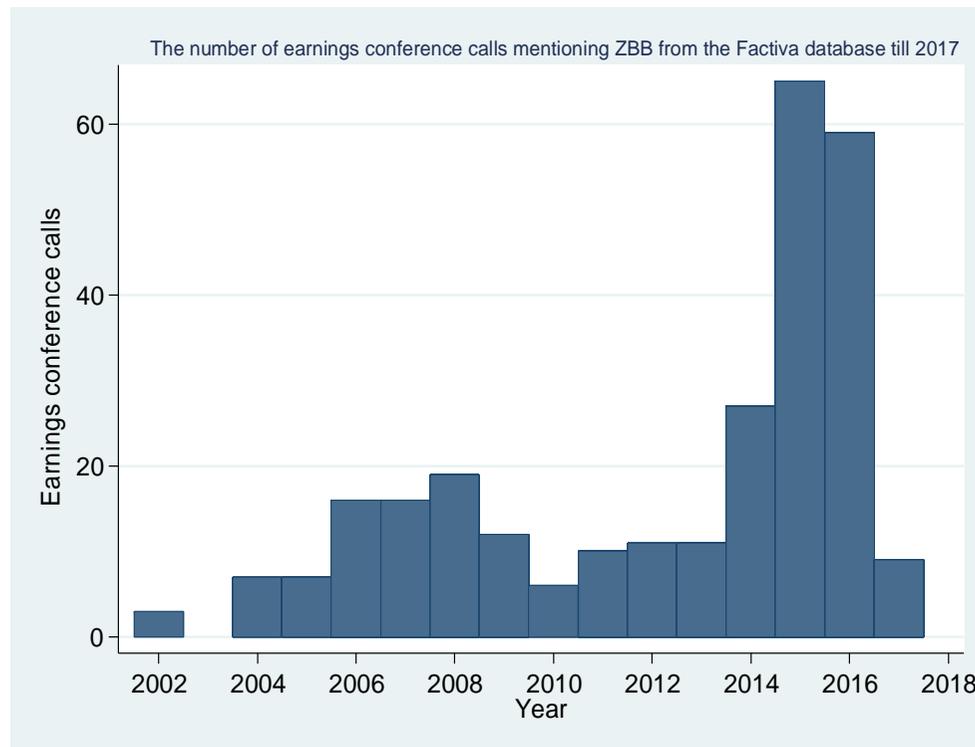


# “Innovative” planning practices

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## Do some budgeting practices re-emerge?

Messner, Coyte, & Zhou (WP): examine the recent “revival” of zero-based budgeting



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# Budgeting as a ritual

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## Several studies have looked at the “ceremonial” nature of budgeting

- Budgeting as a taken-for-granted process that legitimizes subjective decision-making (Pfeffer, 1981; Covalleski & Dirsmith, 1988).
- Covalleski and Dirsmith (1988) highlight how changing such a ritualistic process becomes a “power game“ between a university and the state
- Mazmanian & Beckman (2018) describe budgeting as a **ritual of quantification** that relies upon three types of control:
  - Output control: Budget target as legitimate performance benchmark
  - Process control: Going through set stages with particular activities
  - Normative control: Engaging in the budget process creates personal commitment and emotional investment

# Budgeting as a ritual

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## Ritual also has a pronounced temporal dimension

Kunzi & Messner (WP): how the temporal structure of a budgeting process shapes accountants' experiences and how accountants contribute to this temporal structuring

- Three dimensions of temporal structure (Zerubavel, 1976): (1) sequence/timing, (2) duration, and (3) pace
- Part of the temporal structure is pre-defined for accountants; other parts are subject to active structuring
- Accountants are involved in two kinds of active temporal structuring:
  - *planned* temporal structuring (predictable aspects, routinized behavior)
  - *ad hoc* temporal structuring (non-predictable aspects that entail immediate action; triggered by unexpected events)

# Whither planning/budgeting research?

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## Some reflections



### **Interaction between plans**

- Financial plan (budget) and sales and operations planning
- Strategic plan and budget

### Possible theoretical concerns:

- Loose/tight coupling
- Boundary spanners and objects
- Professional logics

# Whither planning/budgeting research?

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## Some reflections



### **Automated planning**

- Big data and machine learning

### Consequences for:

- Target setting?
- Gaming behavior?
- Ritual of planning?
- Role of accountants?

# Whither planning/budgeting research?

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## Some reflections



## Rolling forecasting/planning

Little systematic evidence on the effects of a rolling process on:

- Work load
- Accuracy
- Target-setting
- Gaming

