Planning and budgeting: whence and whither

AFAANZ Conference 2018

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An ambivalent practice

“… 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?

Plans fulfil different purposes

- Motivation, target setting, control
- Coordination and resource allocation
- External information
Budgeting

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

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

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

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”.

[Image of a chessboard]
Research on budgeting

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

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

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

Misreporting and budgetary targets

Please provide me with the sales forecast for your region for next year

“The higher the forecast that I provide, the higher will be the target that I get…”
## Misreporting

### Frequent gaming behaviors

<table>
<thead>
<tr>
<th>Types of gaming behavior reported</th>
<th>Occasionally</th>
<th>Frequently</th>
</tr>
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<tbody>
<tr>
<td>Negotiating easier targets (“budgetary slack”)</td>
<td>60%</td>
<td>26%</td>
</tr>
<tr>
<td>Spending money at year end to avoid losing it</td>
<td>57%</td>
<td>23%</td>
</tr>
<tr>
<td>Deferring necessary expenditures</td>
<td>52%</td>
<td>39%</td>
</tr>
<tr>
<td>Accelerating sales near year end to make the budget</td>
<td>41%</td>
<td>20%</td>
</tr>
</tbody>
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Source: Libby and Lindsay (2010)
Misreporting

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

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

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

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

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

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

(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

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

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

Do some budgeting practices re-emerge?

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

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Budgeting as a ritual

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

- Budgeting as a taken-for-granted process that legitimizes subjective decision-making (Pfeffer, 1981; Covaleski & Dirsmith, 1988).
- Covaleski 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

Ritual also has a pronounced temporal dimension

Kunzl & 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:
  – \textit{planned} temporal structuring (predictable aspects, routinized behavior)
  – \textit{ad hoc} temporal structuring (non-predictable aspects that entail immediate action; triggered by unexpected events)
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?

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?

Some reflections

Rolling forecasting/planning

Little systematic evidence on the effects of a rolling process on:
- Work load
- Accuracy
- Target-setting
- Gaming
Thank you for your attention