

**Tight Budgetary Control Practices,
Budgetary Slack, and MNC Firm Performance :
Structure as Moderator**

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DEDICATION

This work is specially dedicated to:

my parents, Chang Ching Hong, Hii Pik Ing;

my parent in-laws, Leh Lon Seng, Khoo Hooi Choo;

my beloved wife, Leh Geok Cheng;

my dear children, Jia Ning, Jia Ren.

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ABSTRAK

Umumnya syarikat-syarikat yang tertakluk di bawah garis panduan dan kawalan terhadap perakaunan dan belanjawan mendapat hasil yang di luar jangkaan di akhir tahun kewangan. Penyelidik cuba memahami hubungan di antara amalan kawalan belanjawan yang ketat terhadap sasaran pencapaian belanjawan yang memberi kesan terhadap prestasi kewangan syarikat-syarikat pembuatan multinasional di Malaysia, yang majoriti atau keseluruhannya beribu pejabat di luar negara. Di samping itu, dimensi di dalam struktur organisasi telah dimasukkan sebagai kerangka kajian. Penyelidik percaya ianya akan menjadi faktor penyederhana antara kawalan belanjawan yang ketat dan tahap kelonggaran di dalam mencapai sasaran belanjawan. Pelbagai karya mengenai struktur organisasi mengandaikan ianya memberikan kesan terhadap hubungan tersebut. Sebanyak tujuh puluh maklumbalas yang boleh digunakan telah diterima. Kebolehpercayaan dan kesahihan soalan-soalan menunjukkan ianya adalah signifikan. Analisis deskriptif, Pearson dan regresi baganda telah dilakukan terhadap pembolehubah-pembolehubah. Keseluruhan hasil kajian mencadangkan kekuatan terhadap belanjawan berkaitan komunikasi bersama tahap (tinggi/rendah) penerimaan terhadap kajian semula belanjawan. Ini menjadikan tahap (tinggi/rendah) kelonggaran di dalam sasaran pencapaian belanjawan, menyumbang kepada prestasi yang tinggi/rendah sesebuah syarikat. Dapatan yang kedua membenarkan sasaran belanjawan yang terkeluar daripada yang dihasratkan dan ianya menyumbang kepada pencapaian prestasi kewangan yang tinggi. Kajian membuktikan (mengesahkan) bahawa semakin tinggi tahap kelonggaran dalam

sasaran pencapaian belanjawan, semakin tinggi prestasi kewangan sesebuah firma. Hasil kajian tidak menunjukkan sebarang kesan dalam struktur organisasi sebagai penyederhana.

ABSTRACT

Companies under accounting and budgetary control guidelines in general ended the financial years with surprisingly unexpected results. The researcher seeks to understand the relationship of tight budgetary control practices on the budgetary target achievement, which in turn affects firm financial performance of the Malaysian MNC manufacturers that are majority or wholly foreign owned with their headquarters overseas. In addition, an extra dimension of organizational structure was added to the research framework which the author believes would moderate the relationship between TBC practices and the level of ease in budget target achievement. Numerous articles on organizational structure infer that it does affect the said relationship. Seventy useable replies were received. Reliability and validity of the questionnaires set are adequately significant. Descriptive analysis, Pearson's correlation analysis and multiple regressions were carried out amongst the variables. Reaffirming some existing literatures, the study confirms that the higher / lower the level of ease in budget target achievement, the lower / higher the firm financial performance. A second finding is that lower / higher level of acceptance in budget revision during the year would result in higher / lower level of ease in budget target achievement, which leads to lower / higher firm performance. However the study unexpectedly did not unravel any moderating effect of organizational structure.

CHAPTER 1

INTRODUCTION

1.1 Background of Study

Over the past 25 years, accounting researchers have researched extensively into the relationships of participative budget setting and its corresponding performance. Much remained to be discovered especially in the area of tight budgetary control (TBC) practices and its relationship and impact on subsequent performance. Van der Stede (2001) researched the measuring of TBC practices from 153 regional Belgium general managers. The general managers are at the level immediately below corporate management of large, diversified firms headquartered in Belgium.

This study intends to further the Van der Stede (2001)'s TBC measures to performance of manufacturing firms located in Malaysia. With the exception of a few, most Strategic Business Units (SBUs) in Malaysia are predominantly foreign owned. These SBUs, whether wholly or majority share foreign owned, have different organizational structures that support the business venture. These SBUs are multinational corporations (MNCs) with their headquarters in foreign countries.

Multinational corporations (MNCs) from more than 60 foreign countries have invested in over 3,000 companies in Malaysia's manufacturing sector. Many of them have re-invested in multiple projects (www.mida.gov.my). Some of the MNCs, for instance, the Matsushita Group, has more than 70 manufacturing plants and operating offices in Malaysia. Sony Corporation,

headquartered in Tokyo, has their largest offshore factories located in Malaysia. The world's top five electronic manufacturing services (EMS) have their operations concentrated in the state of Kedah. Some in Kuala Lumpur and others in Johore. Flextronix, Solectron, Jabil, and Celestica, just to name a few, are some of the world renowned EMS in Malaysia.

Malaysia's total export was RM533.79 and RM 480.74 billion for calendar year 2005 and 2004 respectively. Electrical and Electronic Products export accounted for RM 264.70 and RM 241.48 billion for calendar year 2005 and 2004 respectively. This is 49.58% (year 2005) and 50.23% (year 2004) of the total exports. Adding other manufacturing sectors such as Goods and Articles, Apparel and Clothing, Timber and Timber Based Products, Palm Oil and Palm Oil Based Products, and others, the total manufacturing sector in Malaysia exported RM 466.30 and RM 408.00 billion in year 2005 and 2004 respectively. This manufacturing industry employs slightly over a million people (www.statistics.gov.my). Most of the companies in the Electrical and Electronic Products segments are MNCs.

In 2006, Malaysia's total trade was valued at RM1.1 trillion, an increase of 10.5 % from RM967.8 billion in 2005. Exports increased by 10.3 % to RM588.90 billion, and imports increased by 10.7 % to RM480.50 billion. This resulted in an increase of trade surplus to RM108.50 billion in 2006 (www.mida.gov.my).

Per statement by YB Dato' Seri Rafidah Aziz (minister of International Trade and Industry, Malaysia) dated 13th February 2007, "Despite

the increasing global competition, Malaysia continues to attract global foreign outflows, reflecting the country's cost competitiveness as a manufacturing and export base. Foreign direct investments (FDIs) in approved projects in 2006 amounted to RM20.2 billion, the highest level recorded to-date, compared with RM17.9 billion in 2005, and RM13.1 billion in 2004. The electrical and electronic industry attracted RM10.0 billion direct investment, which is 50 % of the total 2006 FDIs. Out of 170 approved FDI projects, 111 projects (RM8 billion) were for expansion / diversification of existing activities." (www.mida.gov.my).

As these MNC manufacturing plants produce or assemble different parts for a myriad of next-in-line customers, the various departments' operations are mostly governed or guided to a certain extent by the guidelines set by the budgets allocated. Jones and Titmas (1955) researched into the setting up of effective budgeting in a manufacturing plant. They concluded that effective budgeting depends upon strong leadership and a simple, well coordinated management organization must be present, and that building and operating a successful budget program is a process.

As most of the MNCs have being operating in Malaysia for many years or some new ones are mere extensions or subsidiaries of the headquarters in different host countries, periodical budgeting exercise is a common practice in manufacturing sectors. The significance and both its theoretical and practical contribution on this study of the relationship of TBC practice on wholly or majority share foreign owned MNCs' subsequent and ultimate financial performance are expounded in section 1.5 and section 6.4 respectively.

Understanding the stated relationship would help to relate to the continued success of FDI's of MNCs' manufacturing activities in Malaysia.

Three contextual factors that may potentially have influenced the results of measuring TBC, cited by Van der Stede (2001), are (a) Organizational level, (b) Size, and (c) National Culture. These factors have being brought up due to the data collected were all referenced to large, diversified firms headquartered in Belgium.

Two of the potential factors cited, organizational level and size, are two of the many measures within the extensively researched domain of organizational structure. In the last 40 years, organizational structure measures such as (a) centralization, (b) decentralization, (c) formalisation, (d) span of control, (e) size, (f) hierarchical levels (vertical differentiation), (g) divisionalisation (horizontal differentiation), (h) number of operating sites (spatial differentiation), (i) specialisation, and (j) departmentalisation (Smith, Grimm, Gannon & Chen, 1991; Hage, 1965; Pugh, Hickson, & Hinings, 1969; Blau, 1970; Burns & Stalker, 1961; Hage & Aiken, 1967; Aiken & Hage, 1971; Aiken et al., 1980; Kimberly & Evanisko, 1981; Hull & Hage, 1982; Damanpour, 1987, 1991; Child, 1974; Ford & Slocum, 1977; Fry, 1982; Van de Ven, 1976; Perrow, 1972) have being extensively researched.

Different dimensions of TBC lead to the aspect of level of ease with which budgetary targets can be achieved. Drury (1985) concluded that if a budget constrained style of evaluation is used, substantial amount of bias is likely to occur and result in budget slack. Findings by Cammann (1976) indicated that

when superiors stresses emphasis on budgetary information for organizational reward allocation, the subordinates responded by creating slack.

Embedded within MNC manufacturing plants are different supporting organizational structures that may have influenced the level of ease with which budgetary targets can be achieved, which in turn affects firm financial performance. There is no literature that looks into the effect of extensively researched organizational structure on the relationship between TBC practice and budgetary slack and subsequently firm financial performance. This study attempts to establish the said relationship.

1.2 Research Problem

The mind boggling excessive expenditure of some of the Enron senior staffs, prior to the firm's total financial collapse in 2001 could have been avoided if TBC practices were enforced and budgetary slack being closely monitored within the Corporate Governance framework. In Malaysia, Perwaja Steel's demise could have been avoided too if TBC practices were adhered to and budgetary slack closely scrutinized (Banaga et al, 1995; Chorafas, 2006). With this *a priori*, surely TBC practices enforcement with a close follow up on the induced budgetary slack contributes towards sound firm financial performance.

Financial performance of many Kuala Lumpur Stock Exchange public listed firms in Malaysia are less than desirable towards every end of the reporting quarter. A recent dismal financial performance of Malaysian Airline System with three quarters of losses in hundreds of millions of ringgit surely sends a clear indication that some financial control practices are amiss.

As with all firm financial issues, they are usually more complex than what meet our eyes. The organizational structures of Enron and Perwaja Steel differ from each other. The former may be a decentralized organization, while the latter, more towards centralisation. These organization structural differences are believed to influence the relationship between TBC practices and ultimately firm financial performance.

What are the financial performance of MNC manufacturing plants in Malaysia that enable them to continually reinvest in Malaysia by way of expansion / diversification of existing activities in Malaysia ? Malaysian FDI inflows has increased year upon year with the highest ever recorded in 2006, where electrical and electronic industry attracted 50 % of the total 2006 FDIs (www.mida.gov.my). Majority of these MNCs have annual budgeting exercise. How are the budget setting and attainment behaviour affect firm financial performance ? Does TBC practices lead ultimately to enhancement of financial performance ? Budgeting exercise loosely carried out, or, not strictly adhered to, or, budgetary slack incorporated, may have significant relationship to MNC firm financial performance. This study intends to research into the effect of tight budgeting control (TBC) practices on budgetary slack (proxy for level of ease in budget target achievement) that in turn affects MNC firm financial performance such as profitability.

In sum, this study is trying to examine the role of TBC practices in subsequently affecting the enhancement of financial performance of majority or wholly foreign owned MNC manufacturing firms in Malaysia. On the other hand,

we also research into the role of organizational structure introduced / influenced by headquarters overseas to influence the relationship between TBC practices and its level of ease of budgetary target achievement that directly impacts firm financial performance.

1.3 Research Questions

When it is near the end of current financial year, the senior management staffs of most majority or wholly foreign owned manufacturing MNC firms in Malaysia prepare budgets for the following financial year. Many firms' budget allocated in the previous year stay unutilized due to excess budgetary slack creation and carry forward to current year, and thus did not realize the full potential of the budget allocated, while others over expended in an untimely manner.

Private information known by the budgeters, if disclosed fully in the budgets setting exercise, can result in gains to the organization from improved resource allocation (Chalos and Haka, 1990). In other words, slack is more representative of the real financial position, which invariably leads to improved firm financial performance as a result of more efficient resource allocation.

It was cited by Van der Stede (2001) that although accounting-based budgetary controls have being extensively researched in management accounting, the literature is still inconclusive as to whether TBCs are beneficial or detrimental to firm performance. Does emphasizing on meeting budget allocated in a timely manner contributes ultimately to financial performance ? Does paying attention to budget details and interim budget deviations by senior staff lead ultimately to

enhanced financial performance ? Has the intensity of budget related communication any bearing on firm's ultimate financial performance ? This study attempts to identify possible relationship between TBC practices and its ultimate firm financial performance.

All manufacturing firms adopt different organizational structures in support of their businesses. Which organizational structure/s is/are amenable to adopt TBC for financial performance enhancement ? The research questions are therefore raised as followings.

- (1) What are the financial performances of wholly and majority foreign owned MNCs in Malaysia ?
- (2) How does TBC practices influence the level of ease with which budgetary targets can be achieved ?
- (3) How does the level of ease of attaining budgetary targets impact financial performance of wholly and majority foreign owned MNCs in Malaysia ?
- (4) How does organizational structure moderate the relationship between TBC practices and the level of ease with which budgetary targets can be achieved ?

1.4 Research Objectives

The author is seeking a more predictable way of ascertaining a manufacturing firm's financial performance with reference to the firm's level of ease of budgetary target achievement and its relationship to TBC practices, and, how the relationship between TBC practices and level of ease of budgetary target achievement is influenced by the firm's organizational structure.

The objectives are as follows :

- (1) To identify the level of financial performance of wholly and majority foreign owned MNCs in Malaysia.
- (2) To examine the relationship between TBC practices and the level of ease with which budgetary targets can be achieved in wholly and majority foreign owned MNCs in Malaysia.
- (3) To examine the relationship between the level of ease with which budgetary targets can be achieved and financial performance of wholly and majority foreign owned MNCs in Malaysia.
- (4) To identify the role of organizational structure in moderating the relationship between TBC practices and the level of ease with which budgetary targets can be achieved.

1.5 Significance of Study

TBC practices is conceptualized to contain five dimensions (Van der Stede, 2001). They are firstly, budget emphasis. Hopwood's (1972, 1973) measure of budget evaluative style has been used to assess budget emphasis (Van der Stede, 2001). However, Van der Stede added a new measure to reflect corporate management and its business unit general managers. Budget emphasis captures the extent to which top management considers meeting the budget on a short-term basis.

Secondly, budget revision. This micro attribute measures the difficulty of getting top management to accept budget revisions during the year. Anthony and Govindarajan (1998) mentioned that there may be procedures to provide a

systematic updating of budgets, if budgets are used as an essential planning tool (Van der Stede, 2001)

Thirdly, budget detail. If top management is only interested in bottom-line of the budget and pays little attention to detail in budget reviews, business managers have more discretion to shift funds between line items to achieve their overall budget (Merchant & Manzoni 1989 as in Van der Stede 2001).

Fourthly, budget deviation. Top managers are intolerant of interim budget deviations if they require business managers to keep the actual performance in line with the budget (Anthony and Govindarajan, 1998 as in Van der Stede 2001).

Fifthly, budget communication intensity. The intensity of budget related communication is measured with reference to Simon's (1995) distinction between interactive (subject to regular discussion between top and business managers, regardless of performance) versus diagnostic control (budgets receive passing consideration unless performance is considerably below expectation). The measure was built up from scratch by Van der Stede (2001) based largely on Simons (1995).

These five dimensions are therefore not new to this present study. The study intends to establish a new relationship between these dimensions' construct of TBC to the level of ease with which budgetary targets can be achieved that in turn affects firm's financial performance. There is currently no literature that explores the said relationship with the mentioned budgetary slack as the mediating variable. The correlation of TBC five dimensions to the level of ease in

budget achievement shall be the first of its kind to be empirically tested in field research. The researcher takes a step further to study the effect and impact of organizational structure on the relationship between TBC dimensions and the level of ease in budget achievement. This would be another maiden study in its own right. This study shall initiate many new insights into the postulated relationship. The results would contribute theoretically to an existing myriad and diverse field of management control.

In terms of practical contribution, the completion of this study on wholly or majority foreign owned MNC manufacturing firms located in Malaysia could add to the knowledge of how TBC practices and level of ease in budget achievement contribute to the wholly or majority Malaysian owned manufacturing firm's financial performance. The significant relationship between TBC practices, level of ease in budget achievement, and firm financial performance, to sound ambitious, can be considered an important framework that could be implemented and enforced by the Accounting Standard Board (ASB) worldwide to prevent the likes of Enron and Perwaja Steel via the framework of Corporate Governance.

At the very least, this significant relationship can be considered by the Malaysian Accounting Board (MAB) or the Kuala Lumpur Stock Exchange (KLSE) governing body to include TBC practices as one of the Corporate Governance (CG) standard guidelines. If implemented, a vast majority of public shareholders interest can be further protected from the potential agency action of the firms' management staff (Jensen & Meckling, 1976).

The study would be able to provide further insights as to which organizational structures are more suitable in adopting TBC practices. We will be able to determine the type of manufacturing organization structures that would be able to synergise with the TBC practices adoption. The result of this study would assist existing MNC manufacturing firms, or those who are considering setting up subsidiaries in Malaysia, to understand what factors contribute to superior firm financial performance. The result would also help to understand which organizational structure typology to embark on that influence financial success.

1.6 Definition of Variables

The theoretical framework has one independent variable, one intervening variable, one dependent variable and one moderator moderating the relationship of the independent variable and intervening variable. The dimensions of which to be used to measure the relationships are stated as followings.

(A) Independent Variables (Tight Budgetary Control)

- Budget emphasis is the level of emphasis on meeting budget (Hopwood,1972, 1973; Brownell, 1985)
- Budget revision is the level of acceptance to budget revision during the year (Anthony & Govindarajan, 1998)
- Budget detail is the level of interest in specific budget line-items (Merchant & Manzoni, 1989)
- Budget deviation is the level of tolerance for deviations from interim budget targets (Anthony & Govindarajan, 1998)

- Budget communication intensity is the level of intensity in budget related communications (Simons, 1995)

(B) Intervening Variable (Budget Slack)

As in Dunk (1993), if subordinates perceive their rewards as dependent on budget attainment, they may try to build slack into their budgets to enhance their compensation prospects. Thus budget emphasis in performance evaluation induces the creation of budgetary slack (Baiman and Lewis, 1989).

Budget Slack is defined and acting as the proxy for the level of ease with which budgetary targets can be achieved.

(C) Dependent Variable (Financial Performance)

As stated in Tuomela (2005), “It is natural to measure performance in financial terms as strategy aims at financial success. The cost of implementing financial indicators is low because they (or their raw data) are produced for external reporting purposes anyway”.

It follows that the dimension profit and return is defined as the level of expectation of performance in targeted contribution margin, targeted profit or income, targeted cashflow, and others (Scott & Tiessen 1999)

(D) Moderators (Organizational Structure)

Centralisation represents the level of concentration of decisions making authority at a specific level in the hierarchy (Gosselin, 1997)

Decentralisation is defined as the level of extent to which various types of power and authority are extended down through the organizational hierarchy (Steers, 1977)

1.7 Organisation of the Remaining Chapters

The following Section 2 discusses the Literature Review on budgets and TBC practices, budget slack, financial performance variable, and organizational structure typologies. In Section 3, Theoretical Framework and Hypotheses are developed. The Research Design and Methodology is described in Section 4. Data Analysis and Findings are reviewed in Section 5. Section 6 discusses and concludes with limitations and suggestions for further research

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

This chapter reviews the existing literatures, seminal papers and other articles that are of relevance to the topic of budgets, budgets as a control mechanism, TBC, budgetary slack, financial performance and organization structures. The individual dimensions of the construct, where literatures are available, are discussed.

2.2 What are Budgets ?

Budgets are accounting techniques to control costs through people and are frequently used as a basis for rewarding or penalizing those who use them as a guideline for cost control. Argyris (1953) mentioned three points about budgets as followings:

- (a) Budgets are evaluation instruments. Because they tend to set goals against which to measure people, they naturally are being complained about.
- (b) Budgets are one of the few evaluation processes that are always in writing and therefore concrete. Thus budgets are sometimes used as a “whipping posts” in order for the supervisors to release their feelings about many other totally unrelated problems.
- (c) Budgets are synonymous to pressure devises that produce unfavourable reactions as do with other kinds of pressure regardless of origin.

2.3 Budgets as a Control Mechanism

Drucker (1964) distinguishes between ‘controls’ and ‘control’. ‘Controls’ are measurement and information that are purely a means to an end and the end is control. ‘Control’ makes sure work is done to fulfill the original intention and ‘controls’ are used to provide information to determine a control function to be taken. ‘Controls’ encompasses all methods and procedures that assist to direct employees towards achieving organizational objectives through congruence.

Norman (1995) has identified three categories of control approaches that are adopted by Ouchi (1979), and Merchant (1998). They are as followings:

- (a) Action (behavioural) controls.
- (b) Personnel and culture (clan and social) controls.
- (c) Results (output) controls.

Merchant (1998) defines action controls as to those situations where the actions are the focus of controls. The action controls are usable and effective only when managers know what actions are beneficial and have authority over the actions outcome. Behavioural controls involve observing the individual’s actions while they are working.

Action/behavioural controls are appropriate only when the cause-and-effect of actions and work relationships are well understood. This controls is more suited towards prevention of undesirable behaviour (Norman, 1995).

Merchant (1998) defines personnel controls as assisting the employees to execute their jobs well done through building the employee's innate natural tendencies to control themselves. Cultural controls represent sets of values, social norms and beliefs that are commonly shared by members of the organization, which ultimately influence their actions. Codes of Conduct and group based rewards are some forms of mechanism to regulate and bring employees to align closer to the organizational goals.

Results or output controls involve establishing performance measures to minimize undesirable behaviour, establishing performance targets, measuring performance, and providing rewards or punishments. Because individual goals differ with organizational goals, controls are necessary to optimize congruency. A major advantage of result controls is that the senior managers do not need to be very knowledgeable about the means required to achieve the results or be involved to observe the actions of subordinates (Norman, 1995).

Management accounting control systems represent the predominant controls in most organizations. They are several reasons why accounting controls appeal to and are commonly practiced in vast majority of organizations.

Firstly, all organizations have the need to explicitly express and aggregate the results of their wide range of dissimilar activities using a common measure. Secondly, accounting controls measures provide the profitability and liquidity measures that are essential to all organizations' success and their respective stakeholders are able to monitor the firm's financial performance through these measures. Thirdly, financial measures enable a common decision

rule based on common denominator of understanding when firms, for instance, decide on an alternate course of action. Fourthly, results controls in financial terms are effective also in uncertain environments when courses of actions are unclear, for instance, market development in an alien country (Norman, 1995).

Management accounting control systems have two core elements. The first is the formal planning processes such as budgeting and long-term planning which are used to establish performance expectations for performance evaluations. The second is responsibility accounting which involves the setting up of responsibility centers, which are, cost or expense centers, revenue centers, profit centers, and investment centers (Norman, 1995).

Despite all the stipulated advantages and theoretical justification of budget as a viable control mechanism, Stewart (pg. 122 Young, 1995), discusses why budgets are bad for business. He said that, "... when you are controlled by a budget, you are not controlling the business..... Reliance on budgets is the fundamental flaw in American management. They assume that everything important can be translated into this quarter's or this year's dollars, and that you can manage the business by managing the money. Just because a budget was not overspent does not mean it was well spent."

Stewart continues, "Budgets, forecast, plans, they become iniquitous when they are made to do more - when budget becomes management's main tool to gauge performance, or when it distorts long-term planning, or blocks managers from shifting resources when they need to. Then the budget becomes an end to itself".

“Managers do incredibly stupid things to make the budget, especially if incentive pay is at stake. They woo marginal customers. They cut prices too deeply. They overload distributors with goods, then take them back or shell out for a costly promotions to sell them”, cited Stewart.

2.4 Tight Budgetary Control (TBC)

Thus the present study has its significance herewith as to contribute to the understanding of the relationship of how tightening the budget control practices affect firm financial performance. The followings are the article reviews that relate to the notion of tightness of budgetary control and its empirically tested effects.

As stated in Birnberg et al. (1983), “while Cleveland (1912) noted the early use of budgets as an account of official stewardship, it was not until Argyris’ (1952) pioneering study that a sustained interest developed in the behavioural aspects of using budgets in a management accounting system”. The budgetary control process was originally viewed as a rational and simple process where the superior’s set budget was communicated to the subordinate and subsequently used as a performance evaluation and for the setting of the next budget.

Cited by Frow et al. (2005) that “Budgetary control is an organizational imperative, but the manner in which it is exercised presupposes stability, certainty and individual-level controllability (Ezzamel & Hart, 1987)”. Budgets stifle innovation and learning because the framework through which budgetary control is exercised encourages individualism, hierarchical dependence,

risk aversion and instrumentality (Roberts, 1991) and budget behaviours are antithesis of innovation and learning (Landfield-Smith, 1997).

Consultants Hope and Fraser (1997), as cited by Frow et al. (1997), have advocated the demise of budgetary control systems on the basis that such systems are barriers to changes required to compete in the new 'information age'. They argued that new management techniques developed under the ever changing environment cannot be successfully implemented if the management is "snapped back" into the old ways under the influence of budget.

In the study by Frow et al. (2005) of a U.K. company that provides both hardware and software products and services, operating in a globally fast-moving and fiercely competitive technology sector, seeks to maintain its market position through continual product development, exhibits a highly organic (decentralized) configuration with an emphasis on learning and innovation. Astoria, the U.K. company in Frow's study, in order to be successful needs to cope with a high rate of strategic adaptation and change and be able to manage in the context of tight budgetary goals. For survival, Astoria has to focus on tight cost control. It is within both these pursuits of tight budgetary control and strategic adaptation and change that Frow et al concluded "The extant literature on budgeting has so far offered little understanding of how processes of budgetary control may be embedded within its wider organizational and strategic framework. As Hopwood (1983) has argued, much accounting research has tended to detach accounting from its organizational context, preferring instead to consider the effects accounting and budgets may have at the level of the

individual”. Frow et al. (2005) therefore calls for further research into the organizational nature of budgeting as the pace of organizational change intensifies.

Birnberg et al. (1983) also details the dysfunctional behaviours of the budgetee under six broad categories. They are (a) smoothing, (b) biasing, (c) focusing, (d) gaming, (e) filtering, and (f) “illegal” acts. Smoothing is the willful distortion of the natural or preplanned flow of data without altering the actual activities within the organization. Biasing is the action of selecting a set of messages that are likely to be accepted and usually most favourable to the budgetee. Focusing is the action where certain aspects of the information set are enhanced (highlighted) or downplayed (hidden). Gaming is the manipulation of the recipient via smoothing, biasing and focusing, taking advantage of the superior (recipient)’s lack of knowledge. Filtering is where less desirable information set is being willfully delayed or omitted while the desirable information set is being communicated. “illegal” act involves violation of company rules and regulation, for example, collusion to swap budget line items for mutual benefit. One can infer that budget setting is a complex matter highly dependent on the budgetee’s behaviours.

A study conducted by Covalski (1983) on the role of budget control in hospital’s nursing services (Mid-Atlantic region, U.S.) reveals that the services’ outputs are unclear where activities cannot be standardized and centralized control is not wholly attainable. Budget is therefore used as a negotiating tool by the

middle managers to advocate their needs to the upper management, whereas, the upper management uses budget to affect control within department.

Interesting results from the findings of Abernethy and Brownell (1999) in the Australian hospital industry show that performance, relative to other hospitals, would be enhanced if budgeting is used interactively when the organization is undergoing strategic change. Alternatively, when top management uses budgeting in an interactive mode with fellow subordinates, the performance increases from the learning and adaptation process required during the formulation and implementation phases of strategic change.

Cited by Van der Stede (2000) that “if budgetary controls are too rigid and business unit managers have too little discretion, corporate management may choke all initiatives that promise long-term or less certain payoffs, as reported by Merchant (1990)”. Van der Stede (2000) has also mentioned that several studies in the management literature documented how an exclusive focus on accounting-based controls encourage short term profit maximization at the expense of long term effectiveness and competitive strength as found in Hayes and Abernathy (1980), Lavery (1996), Merchant (1990) and Merchant and Bruns (1986).

New insights concluded by Van der Stede (2000) are that profitable business units seem less affected by budgetary controls and enjoy more budget slack, whereas, business units with poor past performance seems to pursue more rigid controls via reduced slack which indirectly affect the managers’ concern about short term results. The study was carried out with 153 business unit managers in large, diversified firms headquartered in Belgium.

A study by Flamholtz (1983) postulated the concept of a tri-part control system that consists of the core system, structure and culture. The core system is made up of a varying four degree control with four basic element of planning, operations, measurement and evaluation. As for structure, Flamholtz cited, “organization theorists have argued that organization structure is developed as a response to the problem of control (Blau & Scott, 1962; Hall, 1972; Perrow, 1977; Thompson, 1967)”. The culture aspect determines the nature of the other two components.

For example, an entrepreneurial organization would require a culture that is based on individual initiative, flexibility, reduced bureaucratic control and independence of action. As such, the structure ought to be characterized by decentralisation rather than centralization. Flamholtz (1983) studied three U.S. based company and studied the relationship between accounting, budgeting and control, and concluded that budgeting and even an accounting system cannot be viewed as a control system per se. Budgeting needs to be viewed as a part of a carefully designed total system of organizational control. Linkages between budgeting and other essential elements of accounting measurement and control system need to be adequate for the total system to fulfill its intended functions.

Concluding remarks from Merchant (1984) suggests that “organization characteristics such as functional and differentiation, and the degree of automation of production processes were all positively related to the formality of use of budgeting which includes greater importance placed on meeting the budgets, more formal budget communications, and greater manager participation

in budgeting activities”. He also remarked that product standardization (stage in product life cycle) and strength of market factors (strength of market position) seem to have little or no effect on budgeting.

The study of voice (the subordinate’s involvement in the budgeting process) and explanation (subordinate’s communication of lack of confidence over final budget the superior sets) by Libby (1999), concluded that the combination of the opportunity for voice and the receipt of the explanation had the greatest positive effect on performance. This study implicates a direct link between an increased perception of fairness in budget setting and increased performance. The study was carried out with a group of first-year undergraduate business students to decode symbols which correlated to the budgets to be set.

When managers are confronted with circumstantial uncertainty associated with role ambiguity, Marginson and Odgen (2005)’s analysis suggests that the managers may become more committed to achieving budget targets as budgets offer a source of structure and certainty. The budget therefore provides comfort and security. Such psychological return is conditional upon achieving the budgets. Exceeding or missing the budgets provides little comfort. The managers must then exercise “tight budgetary control” to achieve budgetary targets. The study was carried out in a major UK (FTSE100) based organization that supplies and maintains a range of communications and infotainment products and services to both major private sector companies and large public corporations.

Results from Fisher et al (2002) suggests that when budgets are both used as a basis for allocating scarce productive resources and for evaluating