# BUDGETARY PARTICIPATION IN A PUBLIC SERVICE ORGANIZATION

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## Abstract

In this study the phenomenon of budgetary participation is analyzed. The theories in budgetary participation are described and elaborated. This is a case study and the case is a public service organization, namely the Post Office in Sweden. Empirically two specific research questions are focused.

The first question is the relationships between budget participation and some other budget concepts. These other concepts are the budget style and the budget method. Therefore, the relationships between budget style and participation as well as the choice of budget method and participation were investigated. The results were that the extent of budgetary participation changed from time to time during the four-year research period dependent on the budget style in use. When the extent of participation changed the budget method also changed.

The second research question is the effects of budgetary participation. The effects on the performance and motivation of the subordinate managers are analyzed.

A certain relationship between a lower extent of participation and a higher level of performance can be established in this case, although it may appear strange. The negative relationship probably depends on the fact that the studied organization was in a crisis situation due to the lack of profitability. The relationship is, therefore, dependent on the situation. Thus, the relationship became different from "conventional wisdom" in budget theory, expressed through certain budget literature, for example Becker & Green (1962). The result, nevertheless, agrees with some later research reports which have shown that the relationship is situation-dependent. In this case, the contingent factor is the profitability situation of the organization.

Even a certain relationship between a lower extent of BP and a higher level of motivation existed in this case. Also this result appeared to be situation dependent. The contingent factor was to what degree the budget objectives were experienced as being challenging.

*Key words*: Budget control system; Budgetary participation; Budgeting; The budget process in the Post Office; Different budget methods; Extent of budgetary participation; The negotiation aspect of the budget dialog; Evaluation of the extent of budgetary participation; Effects of budgetary participation; The relationship between budgetary participation and performance and motivation is situation dependent

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# 1. INTRODUCTION

The topic of this study is theories in budgetary participation. Budgetary participation is in this study only named BP. This is an empirical study of the budgetary processes in a Swedish public service corporation, namely the Swedish Post Office Administration, the Post Office (PO).

PO is one of the largest organizations in Sweden. Its turnover in 1996 was SEK 22 billion and the employees numbered 53 000. During the investigated year, 1988, the turnover was SEK 15 billion and the number of employees was 55 000. PO had, during the investigated period, and still has, a geographical form of organization. It was divided into 31 regions each headed by a regional manager who was responsible for the post service administration. Geographically, a region consisted of an administrative province. There were different local authority managers reporting to the regional managers. For example, the local authority of Katrineholm is administered by the regional manager for Södermanland´s administrative province in Eskilstuna. Below the local authority manager are generally a number of managers operationally responsible for their local post offices.

In this study, budgeting, budget and budgetee are defined as follows: Budgeting is a method for financial control which involves the planning and use of a budget. A budget expresses the expectations of a company presented in economic terms for a future time period ( Samuelson 1973 p.31). A budgetee is a subordinate manager that arranges a budget proposal according to the requirements of the superior manager. The budget is thereafter approved by the superior manager after possible revisions. Hence, the budgetee is in this process the subordinate manager who is responsible for the realization of the budget, that is, has a budget responsibility. A budget consequently requires two parties, namely a superior manager and a subordinate manager. The superior manager uses the budget to control the subordinate manager in economic terms, while the budgetee is normally the manager of the decentralized organizational unit in question.

The participation of the budgetee in the budget process can be viewed as one of the decision-making characteristics (Samuelson 1980 p.71). The effects of BP are perhaps the most examined budget aspect in the research literature (Samuelson 1980, Lukka 1988 p.375, Shields & Shields 1998 p.49), although this does not apply to Scandinavian budget literature.

Different definitions of BP can be found in the research literature. Becker and Green (1970 p.375) express BP as a “a process of joint decision making by two or more parties in which the decision has future effects on those making them.” Milani quantifies BP by measuring the influence a budgetee is perceived to have on a budget. This is measured on a scale with seven grades ( Milani 1975). Brownell who has done considerable research on BP generally uses Milani’s definition. Shields & Shields (1998 p.49) mean that BP is usually defined as ” a process in which a manager is involved with, and has influence on, the determination of his or her budget.”

The definition that is used in this study mostly resembles the one used by Hopwood who measures the extent of BP from the following factors (Hopwood 1973 p. 141).

a. The ability for the budgetees to influence the design of the budget.
b. To what extent the superior manager contacts the budgetees.
c. How easy it is for the budgetees to propose alterations in the budget process.
d. To what extent the budgetees participate in the budget's follow-up phase.

Three budget processes were found in PO during the research period. They were the relationships between the enterprise management and the regional managers, between the regional managers and the local authority managers and between the local authority managers and the managers on an operational level. In every process, the subordinate managers (the budgetees) were governed by budget objectives that were established through a budget process.

The research period stretched over four years between 1985 and 1988, making it a longitudinal study.

The main research approach of this study is that the budget is formed to obtain certain intended, so called functionel, effects. This does not always succeed because the functional effects can fail to appear or other effects that are not intended, so called dysfunctional, can appear. This approach is named by Östman ( 1980 p.52) as the effect approach. This means that the properties of the budget process is evaluated according to what effects will arise from the budget. For a more detailed presentation of the effect approach see Samuelson (1993). This approach can be arranged under the behavioral oriented accounting research approaches.

Another approach I use in this study is the situation-dependent theory, also called the contingency theory, which regards the organization as an open system that should adapt to surrounding factors. Whether the budget gives functional or dysfunctional effects depends on, among other things, how well the budget process adjusts to the situation factors. Examples of contingency factors are the size of the organization, the business culture and the profitability situation. This approach has been common in empirical studies of relationships in public organizations (Mäki-Lohiluoma 1994 p.45). Studies of the effects of BP have sometimes used a contingency framework (see Hopwood 1973 and Brownell 1982).

Empirical studies of the budget function characteristics have been pursued to a limited extent in Sweden, see Samuelson (1973), Widebeck (1973), Magnusson (1974), Hägg et al (1982), Anell (1990) and Jönsson (1996). This may seem strange considering that Sweden is a leading country in the development of industrial democracy, which is especially valid in the public sector. Different budget characteristics should be natural to empirical study in such an environment. Even in environments where industrial democracy is less pronounced, for example, in the USA and in Finland, such empirical studies have been usual. However, even in these countries these studies have concerned organizations where the ownership logic structure is privately founded.

In public organizations it has been a tradition for the budgetees to have the possibility of participating in the budget process. This tradition is partially a result of the constitutional control system. According to several writers, the budget has a more essential function as a control instrument in public organizations than in private organizations, see for example Anthony & Young (1994). Among other things, this depends on the fact that the business is often financed by budget grants (Becker & Green 1962, Samuelson 1990 ch.3.3.1).

The overall <u>purpose</u> of this study is to contribute to theories in BP in Scandinavian budget literature by doing an empirical study of BP in a public organization.

More in detail the purpose is to describe and elaborate the theories in BP dealing first with the connection between BP and some other budget concepts and secondly to investigate the effects of BP on performance and motivation and the influence of situation factors behind these effects.

### *Empirical study*

The empirical research was done with four interview surveys and literature studies, using a case study method. For the present study, the case is the budget processes in PO where a total of 75 interviews were conducted. The people interviewed included 31 regional managers, 33 local managers, 5 representatives from PO's board of directors and 6 other head-office managers. The enterprise management consisted of the board of directors while the local managers were selected on a quota-based principle from over 1000 local managers. This implies that the people interviewed were selected to represent the whole population, from all over Sweden as well as from both densely- and sparsely-populated areas.

As seen in figure 1 below, the three budget processes studied are called Process 1, Process 2 and Process 3. In Process 1 the enterprise management is the superior managers and the regional managers are the subordinate managers. In process 2 the same regional managers are the superior managers and the local managers are the subordinate managers. In Process 3 the same local managers are the superior manager and the operative managers are the subordinate manager.

An example of type 2 process is the budget process between the regional manager for Kopparberg's administrative province in Växjö and the local manager in Älmhult. The regional manager is the superior manager and the local manager is the subordinate manager.

The local manager in this process is the budgetee who plans the budget according to budget instructions from the regional manager. The local manager is evaluated on how well he/she achieves the budget objectives which, in this process during the research period, were found to be sales-, expense-, quality-, productivity- and result-objectives. One sales-objective would be, for example, that during a budget year at least an x number of business accounts would be opened in the postal giro service. An expense-objective could be to reduce the work force by 5% or by at least y units. A quality-objective could be to ensure that a normal letter would with 95% certainty reach the destination within 24 hours. The productivity and result objectives were unclear.

| | | |
|---|---|---|
| Superior manager | Enterprise management | **Process 1** |
| Subordinate manager | Regional managers | |
| Superior manager | Regional managers | **Process 2** |
| Subordinate manager | Local managers | |
| Superior manager | Local managers | **Process 3** |
| Subordinate manager | Operative managers | |

Figure 1. The studied budget processes in PO.

An example of Process 3 is the budget process between the local manager in Älmhult and the operative manager of a post office in Älmhult´s municipality.

The <u>interview questions</u> concerned four research areas.

One area dealt with significant steps being taken by the actors during the research period. Questions were also asked about the factors significant for the initiation of these steps.

Another area concerned the actors and how they perceived the budget objectives and the objective levels.

A third area dealt with the functional manner of the budget process in general. The questions in this area were concerned with, among others, how they perceived their own and the behavior of the other actors in the different phases of the budget process. For example, questions were asked about the budget style of the superior managers, the budgetary participation of the subordinate manager and the budget tactical behavior of both parties.

A fourth area constituted questions regarding the relationship between the superior and the subordinate managers. The reward- and the sanction-systems as well as the contact pattern were in focus for this research area. A mapping of the actors' confidence in each other was also included. The same questions were asked in all of the interview surveys, indicating that the survey was structured.

### *Summary of the empirical results*

In the budget processes in PO the effects of the control system varied between the four years, dependent on how the importance of the economic objectives varied. During the first part of the research period it was emphasized that the main objective was to have a general business-like inclination. The budget process was relatively passive during this period and the budget objectives were not especially important for the actors. I call this period the <u>business-like period</u>. It lasted one and a half years.

The business-like period was followed by a retrenchment period during which the objectives of the superior manager were expressed to a higher extent through the budget process than before. Thus, the process was active during this period. Of the budget objectives that were expressed during this period, sales-, expense-, quality-, productivity-and result-objectives, the personnel-expense objective was the most important one. This objective was expressed in the form of a special retrenchment program. This program was caused by PO's poor profitability during this period which also lasted one and a half years. The profitability was then good again.

The core of the empirical observations was made during this period.

Dysfunctional effects depending on the usage of these budget objectives could be seen to a certain extent during this period. They appeared in the form of an inclination which was too short-term and insufficient emphasis on the objectives that were difficult to measure. A side-effect in the form of inadequate work satisfaction and insufficient quality could also be seen during this period.

Simultaneously, large functional effects of the retrenchment program could be observed in terms of both short- and long-term functional effects. Short-term effects were reached through a considerable improvement of the annual result while long-term effects arose through a different economic inclination in PO. This new inclination was to a greater extent than before characterized by cost-efficiency.

During the last part of the research period the budget process was concentrated not only on the personnel-expense objective but also to the same extent on sales-, quality-, productivity- and result-objectives. Even the quality objective was expressed through the budget process. I name this last period the quality-period. It lasted one year.

## 1. RELATIONSHIP BETWEEN BUDGET STYLE, BUDGET METHOD AND BUDGETARY PARTICIPATION

In this section theories in budgetary participation dealing with the relationship between some other budget concepts and BP are described and elaborated. The other budget concepts are the budget style and the character of the budget method.

Thus, the relationship between the budget style and BP is analyzed as well as the relationship between BP and the budget method.

Budget style is the leadership style the superior manager uses in the budget process. "Conventional theory" within the field of budget theory emphasizes the importance this style has on the effects of the budget (see, for example Briers & Hierst 1990 p.396). Budget style shows, for example, how active the superior manager is in the budget process, i.e. to what extent the style is linked to the budget (see Hopwood 1973).

The extent of BP is assessed in this study with Hopwood's above-mentioned definition as a foundation from the basis of the following criteria:

-To what extent the budgetee can influence the design of the budget objectives in the budget's planning phase, criteria 1.

-To what extent the superior and subordinate managers have had budget contacts with each other during this phase, criteria 2.

-To what extent it has been possible to make revisions of the budget during the current budget year, criteria 3.

-To what extent the budgetee has participated in the budget follow-up and the stipulation of possible corrections as a consequence of this follow-up, criteria 4.

The extent of BP in the three phases in the budget process, namely the budget planning phase, the continuous (current) budget year phase and the follow-up phase, is analyzed.

### *Different budget methods during the planning phase*

Four different budget methods can be distinguished depending on the extent of BP in the planning phase.

a. A direct build-up method, where the budgetees participate to a great extent.
b. A direct break-down method, which means a low extent of BP.
c. A method that lies in between the build-up and break-down methods with regard to BP. It is called either a combination or an iterative method, depending on to what extent the budget will be revised. In the iterative method it is revised in several turns (iterations).
d. A conventional method that entails a low extent of BP. The budget is then done in a very simple conventional manner.

A difference between the iterative and the combination methods is that the budget style of the superior manager is somewhat more active at the beginning of the budget-planning phase in the combination method. Another difference is that the iterative method requires more time resources. Both methods mean that the superior manager takes an active part at the beginning of the budget-planning which does not occur in the direct build-up method. There, only the different part-budget proposals of the budgetees are put together, making a final complete budget proposal.

At the beginning of the 70s, around 70% of the larger Swedish companies applied a budget method that mostly resembled the direct build-up method. 10% used a method that was closest to the break-down method (Bergstrand & Olve 1982 p.32).

Figure 2 below describes the relationship between the subordinate manager's BP in the budget planning phase, the superior manager's budget style in this phase and the type of budget method used in PO. It is clear that when the subordinate manager's BP is high and when the superior manager has a passive budget style, the budget method often has a build-up character. A high extent of BP means that the budgetee to a great extent participates in the budget work, according to the criteria that are set above. When BP is high and an active budget style is used, the iterative and combination methods are common.

A low extent of BP and a passive budget style lead to the conventional method, see the lower left square in figure 2. The budget is often planned with the use of the previous year´s budget adjusted for inflation.

| Subordinate manager's BP | Superior manager's budget style: Passive | Active |
|---|---|---|
| High | Build-up method | Iterative method<br>Combination method<br>B |
| Low | Conventional method (B) | Break-down method |

Figure 2. The relationship between BP, budget style and budget method.

BP can also be low and the superior manager active in his/her budget style. Then the budget method often assumes a break-down character. The character B in figure 2 denotes the budget process during the retrenchment period while (B) denotes the budget process during the business-like period. Below, the placements of B and (B) are explained in the figures.

### *BP in the follow-up phase*

The character of the budget process in the other budget phases will largely be decided by the subordinate manager's BP as well as the superior manager's budget style in these phases.

As seen in figure 3 below an active budget follow-up demands, for example, a high BP and an active budget style in the follow-up phase. An active budget style involves an active budget follow-up and requires corrective measures to be taken.

| BP | Budget style: Passive | Active |
|---|---|---|
| High | Budget follow-up reports are made.<br>Deviations are motivated.<br>Corrective measures are rarely taken. | Active budget follow-ups.<br>Responsibility evaluations are made.<br>Corrective measures are taken. |

B

| | | |
|---|---|---|
| <u>Low</u> | (B)<br>Passive budget follow-up. | Responsibility evaluations are based on informal grounds of judgment. Corrective measures are rarely taken. |

Figure 3.The relationship between the extent of BP, the budget style and the character of the budget follow-up phase.

Figure 3 shows that during the follow-up phase an active budget style and a high extent of BP are sometimes needed. This is necessary for the budget follow-up to bring about corrective measures with the budget deviations as a starting point.

### *The negotiation aspect of the budget dialog.*

The budget process often takes on the character of a negotiation process if the subordinate manager is given the possibility of participating in the budget process.

The budget of a decentralized organization is, according to several authors, a product of negotiation (see for example Schiff & Lewin 1970, Samuelson 1980 p.93, Östman 1980 p.22). Some authors even go as far as to say that because the budget process is a type of negotiation it legitimates the budget objectives (Edlund et.al. 1988). The budget process is, according to several authors, more often a process of negotiation in the public sector than in the private sector (see, for example, Johansson & Östman 1995).

Figure 4 below describes what impact BP has during the planning and follow-up phases on the negotiation character of the budget process. If BP is low during the planning phase but high during the follow-up phase, the budget dialog during the follow-up phase often becomes a negotiation between the subordinate and the superior managers concerning the reasons for the deviations. The low extent of BP during the planning phase often means that the subordinate manager in this negotiation feels that the budget levels have not taken into consideration the special conditions of the subordinate manager.

| <u>BP during the planning phase</u> | <u>BP during the follow-up phase.</u> | |
|---|---|---|
| | <u>Low</u> | <u>High</u> |
| <u>High</u> | Budget-negotiations only during the planning phase . | Budget negotiations concerning the causes of the deviations. Active process. |

(B)

| | | | |
|---|---|---|---|
| Low | No budget negotiations. Passive process. | B | Budget negotiations concerning the influence of uncontrollable factors. |

Figure 4. The relationship between the extent of BP during different budget phases and the negotiation-character of the budget dialog.

If the extent of BP is low in both phases, the budget process is passive from the subordinate manager´s point of view. No budget negotiations take place. If the extent of BP is high during the planning phase and low during the follow-up phase, budget negotiations occur only during the planning phase to decide the requirement levels.

If the extent of BP is high in both phases, it implies that the budget has an active role. The budget negotiations then concern the reasons for deviations and the possibilities of taking corrective measures. If BP is low in the planning phase but high in the follow-up phase, budget negotiations often take place during the follow-up phase concerning the influence of uncontrollable factors.

The first research question in the study concerns the relationship between BP and some other budget concepts. The research questions that need to be answered are the following:

a/ What was the relationship between budget style and BP during the research period?
b/ What was the relationship between the budget style and the choice of budget method?
c/ What was the relationship between BP and the choice of budget method?
d/ What was the relationship between the extent of BP and the extent of negotiations in the budget process?

### *Empirical observations*

### *BP during the budget planning phase*

In the first budget planning process during the business-like period the budget method was something between the break-down method and the conventional method. It was nearest the lower left square in figure 2 and is characterized as (B). Both parties spent relatively little time on the budget process.

The empirical study showed that the budget method in PO during the retrenchment and quality periods was a mix between the iterative, combination, and break-down methods. The main method was the latter. This means that the superior managers spent a great deal of time and attention on the design of the budget, i.e.the budget style was active. BP was not so high. Figure 2 shows where the budget processes during the retrenchment period, B, fall into the four-squared diagram.

During the retrenchment period the budget method was nearest to a break-down one, with some iterative elements. Both the enterprise management and the regional managements were extremely active in their function as superior managers in Process 1 respectively in Process 2. The same pattern was repeated during the quality period except that the method was of an iterative nature. Process 3 was the only budget process still with a solely break-down character.

During the retrenchment period the budget proposals were in general made by the subordinate manager. This was done after careful budget directions from the superior manager. The aim of these directions was to improve PO's profit situation. During the design of the budget directions the subordinate manager in general had solely an advisory function. Thus, these directions were designed by the superior manager in the three different budget processes with Process 1 as the model.

The regional managers thought that they as superior managers let their subordinate managers participate a great deal more in the planning phase than they themselves had been allowed. 60% considered this to be true. The subordinate manager had a different view. Only 40% of the local managers stated that they had been able to participate in the budget planning phase, when these managers were the subordinate manager in Process 2. Thus, BP was relatively low during the planning phase on all levels during the retrenchment period.

The regional and the local managers experienced their situation in their capacity of being the subordinate manager relatively similar during the retrenchment period. The different levels had similar opinions about their own BP, about the budget style of the superior manager during the planning phase, about the nature of negotiation in the planning phase and about the reasonability of the final budget contract.

The most essential common opinion was that the participation during the budget planning phase was to a great extent a pseudo-participation. It was not a real participation but a participation of appearance-character (compare with Argyris 1952). This empirical conclusion is drawn on the basis of the following empirical observations:

- 70% (80%) of the regional and local managers have received revisions on their budget proposals from the superior manager. The share figures of the regional managers are shown first, thereafter, in parentheses the share numbers of the local managers.

- 55% (45%) were clearly negative to these budget revisions. This was due to the fact that the revisions complicated their own control.

- Only 30% (40%) stated that they, according to their own opinion, had participated to a sufficient extent in the planning phase. 35% (20%) stated that they hardly participated at all.

- 40% (50%) were dissatisfied with the design of the final budget.

A great deal of the geographical managers seemed thus to view their own participation during the planning phase as a pseudo-participation during the retrenchment period. Despite this, they were not unduly critical of the fact that the superior manager used a budget method of a break-down character. 55% (50%) were clearly positive to the superior manager's relatively extensive budget directions. Because of PO´s lack of profit during this period, the geographical managers generally believed that the superior manager should dominate the budget process. For only 10% (20%) the budget planning process had caused a deteriorated relationship with the superior manager.

> "It has not affected my relationship with the regional management, because we know that they are given directions from the head office, so we have full understanding."
> "I think that the budget process as a whole has not affected our contacts with the enterprise management and we still regard each other with respect."

Another empirical observation from this study is that the superior manager in general assumed that the subordinate manager had a higher BP than the subordinate manager self thought it had. This observation is interesting because it can be generalized.

### *BP in the remaining budget phases*

In the remaining phases of the budget process, namely the continuous and the follow-up phases, the superior manager´s budget style was still relatively passive. This, however, made it possible for the subordinate managers to become active in terms of making budget revisions during the current budget year, i.e. their BP was high. During the follow-up phase there was the opportunity to explain that budget deviations were due to the influence of uncontrollable factors or that the budget obligation was unclear.

Therefore, the budget processes during the retrenchment period, B, ends up approximately in the middle of the four-square diagram in figure 3 above, from having been placed in the lower left section of the figure during the business-like period. The subordinate manager's BP in the follow-up phase during the retrenchment period was neither high nor low.

There was a certain amount of budget follow-up from the superior manager. However, this seldom led to any corrective measures. Therefore, the budget style was neither active nor passive in the follow-up phase of the budget. The enterprise management had some ambitions that the formal budget follow-up should be used for an evaluation. This did not succeed because of PO's poor information systems. Several research reports in the area of economic control emphasize the importance of the influence-principle which means that the budgetees should be able to influence the outcome of the budget. If the accounting systems are defective this principle is no longer valid. It is then difficult to discern the uncontrollable facts from the controllable ones and thereby, to carry out the necessary corrective measures (see, for example, Johansson & Östman 1995).

### *Evaluation of the extent of BP.*

Based on the four criteria mentioned above a conclusive evaluation of the extent of BP during the retrenchment period was conducted. This period is chosen because as said above the core of empirical observations come from this period. The evaluation provided the following results:

During this period the opportunities for the subordinate manager to influence the design of the budget objectives diminished as a result of an increased budget pressure from the superior manager. Consequently, the extent of BP was low according to criteria 1.

The BP in budget meetings and other public budget contacts were of a pseudo-character because the superior manager would not allow itself to be influenced by the subordinate manager's arguments. Even criteria 2 shows that BP is low.

The enterprise management stated that even the budgetees' possibilities of making revisions were reduced during the current budget year, according to criteria 3. My empirical study showed, however, a different result. The extent of BP during the current budget year continued to be relatively high.

Even during the follow-up phase the subordinate manager had the possibility of participating because of the passivity of the superior manager, according to criteria 4.

According to criteria 1 and 2, the BP was consequently low during the retrenchment period, but according to criteria 3 and 4, it was not as low.

### *The negotiation aspect*

In PO the budget processes tended to take on the nature of a negotiation.

40% of the regional managers and 60% of the local managers thought that their budget dialog during the planning phase assumed the nature of negotiation during the retrenchment period. However, they did not think that the two parties were equals during these negotiations. 65% of the regional and 75% of the local managers thought that the superior managers were the dominant party during these negotiations. The further down one was in the organization, the more unequal one thought this relationship was.

The enterprise management emphasized during the regional management meetings that the budget was not to become a negotiation product.

> ”In my capacity as one of two division managers in PO and deputy DG, I do not negotiate the budget. I do not accept that the budget process becomes a negotiation game.”

In their capacity of being the subordinate manager 90% of the regional and 85% of the local managers referred to the conditions of their own units in these negotiations. The superior manager, on the other hand, referred to poor profitability. It also compared one subordinate manager to the other, which the subordinate managers in general did not like.

> ”We usually refer to the fact that we are a sparsely-populated region and there is a difference between us and other regions. They try the ”cheese slicer ” on us, but we maintain that there is no margin in our budget.”

The empirical study showed that the character of the budget dialog changed during the research period depending on, among other things, the changed extent of BP.

The budget processes during the business-like period, (B), are estimated to be in the middle of figure 4. Negotiations were then possible during all the budget phases. The processes during the retrenchment period, B, are clearly below (B) in the figure. A negotiation dialog between the parties was then only present during the follow-up phase. This negotiation was also of a pseudo-character.

Research question 1: Its four- part questions were answered in the following way:

a. BP was quite high during the business-like period when the budget style was passive. During the retrenchment period, when the budget style was more active, BP was reduced and became rather low. Thus, a relationship between budget style and BP seemed to exist.
b. There was also a relationship between budget style and the choice of budget method. When the budget style was more active the budget method became less of a build-up and more of a break-down nature.
c. There existed a relationship between BP and the budget method. In this case, the budget method changed from the conventional to the break-down method when the extent of BP decreased.
d. This empirical study showed that there is a relationship between the extent of BP and to what extent the budget process assumes the character of a negotiation. When the extent of BP decreased the extent of budget negotiation also diminished or the negotiations became more of a pseudo character.

Conclusions that are drawn from this part of the study are the following:

When the extent of BP is high the budget process often assumes the character of a negotiation. If the superior manager does not wish to have a negotiation process for being able to raise the budget objectives, the manager has to try to reduce the BP. A lower extent of BP and a break-down budget method seems necessary if the superior manager in the short run wants to increase the budget objectives.

However, several researchers believe that in organizations where the management is trying to intensify the budget control system, the extent of BP often needs to increase, (see for example, Argyris 1952). This is requested so that the budgetees would accept higher budget objectives and also any possible negative budget deviations, (see Magner and others 1995). This can happen through the budgetees using a budget metod of a more iterative nature. This also took place in this case during the last subperiod, the quality period. Thus, in the long term it seems to be necessary for the superior manager to again adopt a larger extent of BP and a more iterative method to gain acceptance from the budgetees for the increased budget objectives.

3. THE EFFECTS OF BUDGETARY PARTICIPATION

Below, BP's effects on performance and motivation of the budgetees are analyzed.

The independent variable in this analysis is the extent of BP and the dependent variables are performance and motivation of the budgetees.

**Influence on performance**

Researchers have found different results concerning the effects of BP on the performance of the budgetees.

Most studies have found a clearly positive relationship between BP and performance. Some have found a negative relationship while other studies have not found any relationship at all. Mostly, a positive relationship have been found. For a description of the results of different studies, 47 studies, see Shields & Shields (1998 p.71-75).

Other additional studies have established that the direction of the relationship depends on the situation the company finds itself in (see, for example, Hopwood 1973 and Brownell 1982). Hofstede (1967 ch.6) gathered that the character of the work played a role regarding this relationship. If the job was routine and mechanical, BP would lead to a negative influence on performance. On the other hand, if the job demanded an innovative skill, BP would have a positive influence on performance. Mia (1989) found that if the work was experienced as difficult, BP would have a positive influence on performance, but if the work was experienced as easy, the budgetee would find that participation was unnecessary and ineffective, and performance decreased when BP increased. O'Connor (1995) found that the type of company culture was an important aspect concerning this relationship.

In the general debate in Sweden as well as internationally, there is a perception that the relationship between BP and performance is positive. It is considered to depend on the following three factors:

-BP increases the acceptance and the motivation (Milani 1975).

-BP makes the budgetee to a greater extent feel responsible for the organization's goals because it internalizes the goals.

-BP improves the information system in the organization (Becker & Green 1962 and Hofstede 1967).

Researchers who have found a negative relationship between BP and performance are, for example, Stedry (1960) and Schiff & Lewin (1970). They have in general explained this with the fact that the budgetee exploits the BP to create ”budget-slacks”. The reason for this is that, according to them, there is a conflict between the organization’s and the individual’s goals (see Cyert & March 1963 and. Arwidi & Samuelson 1991 part 6.7). Stedry (1960) showed theoretically that the budgetees try to lower the budget objective levels to their aspiration levels through BP during the planning phase. When the budget levels have been determined beforehand they seek to increase their aspiration levels up to the objective levels. BP then leads to lower achievement levels than when the opportunity for BP is not given.

The different results of BP’s influence on achievement have, according to Otley (1984 p.134), led to a situation whereby ”an overall impression left is thus one of considerable confusion”.

In answering the first survey question it was established that BP diminished during the retrenchment period. Charpentier (1992) learned that performance increased during this period. Here, it is analyzed whether there is a relationship between the decreased BP and the increased achievement level, and if there is, what this relationship is due to.

The <u>second research question</u> of the study is to analyze the relationship between the extent of BP and the performance of the budgetees and the decisive factors behind this relationship.

### *Empirical observations, analysis and conclusions*

It is consequently observed that the BP of the budgetees decreased during the retrenchment period at the same time as their performance increased.

A possible relationship between the decreasing BP and the improved achievement level can from the research literature be explained by the following three factors:

-Decreased budget tactical performance.

-The forced higher objective levels increased the aspiration level and the actors’ motivation. The objectives were positively challenging.

-The assignments could, on an operative level, have been experienced as relatively routine and easy to perform. Hence, a high extent of BP seemed unnecessary to the budgetees (compare with Mia 1989).

Except the three above-mentioned reasons, the positive influence on performance can be explained from the perspective of a rational theoretical decision model .

Samuelson (1973) lines up different criteria for how decentralized decision making, for example, by increasing the BP, affects the efficiency of the six levels of the decision process. These are the objective-planning, action-generating, action-evaluating, decision-making, realization and follow-up levels.

Below, an analysis is conducted on how a decreased BP influences the efficiency of the six levels of the budgetees' decision process. An improved efficiency would mean increased performance.

The first level is the objective-planning level where the objective validity is used as a criterion for the efficiency.

The staff of PO's Director-General had derived the objective levels during the retrenchment period from the profit objective of 5% of the turnover in PO. With this objective PO would get away from the poor profitibility situation. This objective was successfully achieved. The low possibility for BP during the budget's planning phase could have improved the budgetees' objective validity. The budgetees were not given the possibility of influencing the objectives for their own gain.

The next two levels in the decision process are the generating and the evaluating levels, during which an increased BP is generally positive for the efficiency of the decision process. It increases learning, creativity and improves the prediction capacity through access to the budgetees' private information being granted (Kolb 1984 and Jönsson 1996 p.123). For these two levels a reduced BP would have reduced the efficiency. Therefore, the budgetees' performance should be reduced.

During the next level, the decision-making level, it is uncertain whether a reduced BP influences the efficiency. It can increase because the decision-making is simplified, but it can also be reduced because of the deterioration of realism, see below.

During the realization level BP was not so low. The subordinate manager had the possibilities of making budget corrections.

Whether a decreased BP gives a decreased or increased efficiency during the last level, the follow-up level, depends on the precision of the follow-up and the extent of delay. Reduced BP can give a higher extent of delay of the follow-up information. However, precision can also be improved. This is caused by a decreased extent of BP giving lesser possibilities of manipulating the reports.

A reduced BP gives deteriorated feed-back information, which diminishes the realism. According to Becker & Green (1962) this disadvantage is so important that the total effect of a reduced BP is a deteriorating performance. However, in this case, because the information systems were insufficient, the extent of BP could not change this.

<u>To sum up</u>, the conclusion from the above analysis is the following: The possible positive influence on the efficiency of the reduced BP can be derived from the effects that arose during the first level of the decision-process, the objective-planning level. The decreased extent of BP increased the efficiency during this level. PO received a more economic direction characterized by more economic efficiency. The possible negative influence on creativity and realism during the other levels need not have been larger than the positive influence on efficiency during the objective-planning level.

This partly depended on the retrenchment period being so short that the negative influence did not have time to break through properly.

Research question 2 was answered in the following manner: A relationship between the extent of BP and the efficiency of the decision process could be established and was in this case negative. The decreasing extent of BP contributed to an increase in performance during the retrenchment period. According to the analysis above, the cause of this negative relationship was the decreased extent of BP increasing the budgetees´ objective validity. Therefore, the budgetees were more willing to accept the budget objectives which became more important to them. An important factor for this willingness was PO's poor profitability situation during this period. This situation made the budgetees accept a decreased BP and increased their objective validity.

A conclusion that can be drawn from this study is that a decreased extent of BP in some situations can lead to an increase in the performance of the budgetees. This result confirms the results from the contingency theory.

## Influence on motivation

As implied above, several researchers have explained possible positive connections between BP and performance with the claim that BP improves the motivation of the budgetees ( see, for example, Samuelson 1996).

Other researchers explain the positive effects of BP on performance through an information-theoretical perspective. Because BP gives the budgetees a higher extent of feedback information, performance is also increased ( see, for example, Becker & Green 1962). The budgetees can adjust their aspiration and budget-objective levels more realistically. A discrepancy between the objective level and the aspiration level does is, in fact, decrease motivation. Several researchers have found that objective levels that are clearly above the aspiration level decrease motivation (see, for example Argyris 1952, Ridgway 1956, Hofstede 1967 and Hopwood 1973).

According to Becker & Green (1962) the decreasing budget motivation led to a change in the budget procedure in the public sector so that an increased BP was made possible. The earlier routine with forced objective levels produced individual stress and poor motivation.

On the other hand, some researchers have not found a positive relationship between BP and motivation (see, for example, Brownell & McInnes 1986 and Mia 1989). Brownell's & McInnes' results are accounted for below.[1] Stedry (1960) even observed a negative relationship. His conclusion is that when the budget-objective levels are perceived as high they are seen as a challenge and the motivation increases. Hofstede confirms in his empirical studies that high objective-levels can increase motivation. Hofstede learned that personality, length of employment, age and cultural differences

[1] Shields &Shields (1998 p.72) mean that there is a significant positive association with both performance and motivation in this study. I have only found a positive association with performance. My interpretation is with other words different from Shield & Shields´.

are important factors when deciding how the individual will react to increased budget levels (Hofstede 1967 ch.8). Even Östman learned that individual personality factors are important for how the budgetee will act in the budget-process (Östman 1977 part 5.2 and p.266). Hofstede (1967 ch.9) does not confirm Stedry´s relationship between BP and motivation. BP could, to some extent, prevent the budget objectives from becoming too high. At the same time Hofstede found, as did Becker & Green (1962) and Benston (1963), that exchange of information increased because of BP. The budgetees then accepted more willingly the budget process and its objectives .

Thus, different researchers have found different relationships between BP and motivation, but the dominating view is that the relationship is positive. For a summary of the results of different studies, see Shields & Shields (1998 p.71-75).

Research question 3 is to analyze how the relationship between the extent of BP and motivation was in this case and examine the decisive factors behind this relationship.

### *Empirical observations*

For the local managers from smaller districts, the empirical study gave the impression that their motivation already before the retrenchment period had been relatively high and that it continued on the same level during this period. 60% of the local managers in the smaller districts did not, for example, see any drawbacks with the job at all. The retrenchment program did not seem to improve or make their motivation worse. The same was true for many local managers from medium-sized districts and regional managers from rural regions.

That the decreased BP during the retrenchment period did not diminish the level of motivation for the managers from rural regions and districts could have several reasons.

a. The presumed increased objective validity, according to the analysis above, could have improved the work situation for these managers. For geographical managers especially problem-oriented individuals had been selected. Almost all of the regional managers from the rural regions considered that their most important measure thus far was to improve the internal economical control system. To be able to use this economical control system to reach a clearly defined business objective was perceived as a challenge. The situation was the same for many local managers, most of whom were newly appointed, from small and medium-sized districts. Due to the retrenchment program they faced a challenge.

b. The objective levels for these geographical managers did not change as a result of the retrenchment program to the same extent as it did for the geographical managers from the large city districts.

c. The dysfunctional effects, mainly in the form of quality deficiencies, of the retrenchment program were not especially large for the rural geographical managers either.

For geographical managers from large city districts the empirical observations gave a different picture. Most of the large city managers appeared to have a clearly decreasing level of motivation because of the retrenchment program.

The decreased level of motivation for these managers could depend on the following three causes:

- The discrepancies between aspiration and objective levels became too large for them.

- The dysfunctional effects that most of the large city managers experienced during the retrenchment period decreased their motivation.

- The reward system did not stimulate the motivation.

Thus, the relationship between the retrenchment program and the level of motivation in this empirical study seemed to be the following:

With increased budget objective levels and decreased extent of BP, the program came to influence the budgetees' motivation. For the majority of the geographical managers the motivation level seemed to have improved. For the large city managers, on the other hand, the level of motivation seemed to have decreased.

With the help of Brownell's & McInnes'(1986) empirical study, an attempt will be made to explain why the decreased BP for most of the geographical managers led to an improved level of motivation, that is, why the relationship between BP and motivation was negative for these budgetees.

Brownell & McInnes hypothesised in an empirical study that an increased BP should increase motivation. They based the hypothesis on, among other things, the results from Merchant (1981). Brownell & McInnes used an expectation model that was introduced to accounting literature by Ronen & Livingstone (1975) to measure the motivation of the budgetees in a quantitative manner. The important variables in this model are the following:

1) The self-satisfaction of working toward the budget objectives, IVb. 2) The expectation of reaching the budget objectives, P1. 3) The selfsatisfaction of reaching the objectives, IVa. 4) The expectation of obtaining the rewards because the objectives have been reached, Pi. 5) The satisfaction of obtaining the rewards that are dependent on reaching the budget objectives, EVi.

The motivation formula is then $M=IVb+P1*(IVa+Pi*EVi)$. M in the formula stands for the budgetees' motivation.

Brownell & McInnees hypothesised that the self-satisfaction of reaching the objectives, IVa, should increase if BP increased, because the budgetees would then be more involved in the decisions. The result of their empirical study, however, was that this variable had a negative relationship with BP. The researchers' explanation for this was that reaching the budget objectives was not then so exciting for the budgetees. An increased BP gives the possibility of introducing ”slack” in the budget levels. Because of this, the researchers also found a negative relationship between BP and the satisfaction of obtaining the rewards that are linked with reaching the objectives, EVi. The rewards are perceived as less attractive when one has to try less hard.

The researchers also found a negative relation between BP and IVb. A positive relationship existed in their study between the expectation factors, P1 and Pi, and BP. An increased extent of BP made the budget objectives seem easier to reach for the budgetees. The possibility of introducing ”slacks” increased expectation.

However, taken as a whole, their study meant that a positive relationship between BP and motivation was not established, that is[2], the result was about the same as the one arrived at in my study.

An explanation of my result is that, according to Brownells & McInnes' findings, the increased objective levels in PO could have meant that the geographical managers saw a positive challenge in the retrenchment program, that the self-satisfaction of working toward the budget objectives, IVb, increased. What argues for the objectives being perceived as challenging is the high share of managers that took special measures to be able to manage the retrenchment program.

IVa could even have increased due to the retrenchment program. This conclusion is drawn partly because of the high percentage of managers who found that the special retrenchment activities had better effects than they expected, partly because the subordinate managers were aware that reaching the objectives of this program made the superior managers satisfied with their business.

To reach an objective as challenging as the retrenchment program can, consequently, have meant an increased satisfaction for oneself and more satisfied superior managers.

The expectations of the budgetees of reaching the budget goals, P1, and the expectations of obtaining the rewards that are linked with the objective, Pi, normally diminish when the extent of BP is decreased. However, this did not seem to be the case in this example. Instead, P1 and Pi seemed to increase when BP decreased.

The explanation for this could be the following: For most of the budgetees, the retrenchment program meant that the expectations of reaching the objectives diminished. However, this was not true for the most important objective, namely the employee-expense objective. Its realization was reached at the cost of the other objectives.

Brownell & McInnes found a negative correlation between the extent of BP and EVi, the satisfaction of reaching the rewards that are dependent on reaching the budget objectives. EVi could, therefore, have increased in PO because of the decreased level of BP.

[2] They found that this relationship was unclear but probably negative. However, they found a significant positive association between BP and performance.

Research question 3 is answered in the following manner: The retrenchment program was a consequence of PO’s poor profitability during this period. This program meant increased budget objective levels and decreased BP. This program probably increased the budgetees’ self-satisfaction of reaching the budget goals. The conclusion is that a decreased level of BP does not necessarily have to reduce motivation. On the contrary, in some situations motivation can even increase. Consequently, even this relationship is situation dependent. The result is in agreement with Brownell & Mc Innes´ (1986) findings, but not with, for example, Milani´s (1975).

## Concluding remarks

In this case a negative relationship between BP and performance and motivation was established. The reduced BP during the retrenchment period led to both increased performance and motivation. The relationship became different from ”conventional wisdom” in budget theory, expressed through certain budget literature, (see, for example, Argyris 1952 and Becker Green 1962). In the research literature, it is difficult to find corresponding empirical results. Since the analysis points to these relationships being situation dependent, these results can arise in certain specific situations.

A conclusion from this analysis is that the relationship between the extent of BP and the level of performance and motivation is situation dependent. In this case, the important contingent factor was the profitability situation of the organization which increased the willingness of the budgetees to accept lower BP and increasing budget objectives and implied that the budget objectives were perceived as challenging.

Regarding the future development of the extent of BP in Swedish public service corporations, there are reasons to assume that BP during the budget’s planning phase will increase in the long run. The tradition in Swedish public administration is that the extent of BP should be relatively high. The increasingly uncertain situation for these corporations demands an innovative strategy to survive and this demands a high extent of BP (see Hofstede 1967, Macintoch 1985 ch.11, Ezzamel 1989).

The influence from the innovative strategy on the extent of BP could be seen during the quality period. The extent of BP then increased somewhat. During this period the private information from the budgetees could thereby be taken care of to a greater extent than before.

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