



The appropriateness of tight budget control in public sector organizations facing budget turbulence



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ABSTRACT

In the public sector, budget deviations are an important performance dimension. Because of political and institutional pressures, it is crucial that public sector organizations neither overspend, nor underspend. Budget deviations actualize the issue of tight budget control. In this article we hypothesize that when public sector organizations face budget turbulence, the implementation of tight budget control is a functional response that increases the likelihood of meeting budget targets. Our study, combining survey and archival data from 196 Swedish municipalities, confirms our hypothesis. If budget turbulence is substantial, public sector organizations benefit from tight budget control as they seek to control budget deviations, but if turbulence is only marginal, they can conduct activities in the same manner as last year and additional direction from tight controls has no effect on budget deviations. A more general contribution of the paper is the evaluation of the effect of environment and tight budgetary control fit on budgetary performance.

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1. Introduction

Budgeting and budget control represent the central logic for planning, control, and accountability in public sector organizations. It remains so despite the general criticism of budget control in the accounting literature (Marginson and Ogden, 2005) and the beyond budgeting literature (Wallander, 1999; Hope and Fraser, 2003; Bourmistrov and Kaarboe, 2013). The rationale of public sector budgeting is that allocated resources are to be used for welfare (policy) purposes. If economic resources in the budget are not used and transformed into welfare services, the realization of political priorities is not completed and the public sector organization adds less value to citizens than politically intended. Thus, budget surpluses

are signs of insufficient budget discipline with implications for democracy and welfare. However, this budget control-related problem is not the most common type. Rather, many public sector organizations face dire economic difficulties forcing them to reduce spending. This means cutbacks in budgets and subsequent challenges to comply with spending levels. Even if budgets are balanced before the fiscal year, the outcome may be a deficit; presumably due to a combination of tough budget targets and insufficient budget control. From a societal perspective, failure to control budget deviations is problematic.

Against this background, it is surprising how little research has been devoted to the design, use, and effectiveness of public sector budget control systems in controlling budgets and budgeting behaviour. Literature reviews of accounting research on budget control show an almost complete dominance of research on private sector organizations (Chapman, 1997; Hartmann, 2000; Chenhall, 2003). In a similar vein, according to a recent review of public sector budgeting research in the accounting

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and public administration literature, research on budget control-related outcomes is non-existing (Anessi-Pessina et al., 2012). The accounting research still conducted on public sector budgeting has historically dealt with budgeting and budget controls in connection with accounting changes (the New Public Management movement) and implementation at the sector level (Anessi-Pessina et al., 2012) and in budgeting decision-making processes (e.g., Wildavsky, 1975; Jönsson, 1982; Boland and Pandy, 1986; Covaleski and Dirshmit, 1988). With the contextual framing of global economic turbulence and fiscally stressed public sector organizations in mind, we aim to redress the lack of budget control research in the public sector by focusing on the role of tight budget control for controlling budget deviations in organizations facing environmental economic turbulence in the form of changing budgets. The new economic circumstances mean that public sector organizations need to amplify and refocus their budget control activities towards goal achievement. The new spending limits, prioritizations, and performance levels increase the need for direction on how to perform and what is important. Tight budget control is argued to be a structure that facilitates these needs.

In addition to creating knowledge about the suitability of budget controls in public sector organizations this paper adds to the literature on the appropriateness of budget control systems in turbulent environments. Previous research on private sector organizations has shown that budget emphasis and reliance on formal budget controls is appropriate in turbulent environments (Khandwalla, 1972; Otley, 1978; Ezzamel, 1990; Gosh and Willinger, 2012). In these studies the researchers make the (implicit) assumption that only organizations that are aligned with their environment survive (exist to be observed) and that a relationship between environmental characteristics (independent variable(s)) and the budget control system (dependent variable) is indicative of a *selection type* of contingency fit (Drazin and Van de Ven, 1985; Chenhall, 2003; Gerdin and Greve, 2004). Thus, previous studies have only assumed a performance effect, but not explicitly tested for it. Furthermore, when applying the selection type of fit, performance is of a global character (market survival) rather than the more direct outcome of a budget control system such as budgetary performance. With an *interaction type* of contingency fit approach, it is possible to directly test the effect of fit between turbulence and budget control on budgetary performance. This approach allows evaluating if organizations that use tight (formal and extensive) budget controls when facing environmental turbulence have better control over their budgets *vis-à-vis* organizations that do not. Such knowledge is of interest from both a theoretical and practical perspective.

However, moving away from the selection type of contingency studies to interaction type studies means that we need to argue for a case where misfit combinations are likely to exist (i.e. are not weeded out effectively by the environment). Like Johansson (2013), we believe that the public sector is a good setting to test interaction type of contingency theories. The public sector is characterized by the lack of a competitive market, conflicting demands, presence of non-trivial input rigidities and a

democratic and political process. Time lags and choices informed by non-economic incentives will lead to a situation where one can expect to find misfit adaptations (Johansson, 2013). In combination with strong institutional and political pressures for budget compliance (performance) in these organizations, it is reasonable to assume that they strive for environmental adaptation, but that one will find variation in adaptation (fit) that can be related to budgetary performance. Studying the importance of a proper alignment between environmental turbulence and budget design for budgetary performance in public sector organizations thus represents an interesting case for developing the contingency-based literature on budget control design in turbulent environments.

By investigating the appropriateness of tight budget control in public sector organizations, we also respond to the general call for more research on the intended and positive effects of budget control; rather than focusing only on the dysfunctions of budget controls (Hartmann, 2000; Marginson and Ogden, 2005). The lack of studies on budget control related outcomes within the public sector might be one reason for this bias in the literature. In most research on private sector organizations the control problem is one of spurring motivation to perform better (e.g. maximize profit or sales) and in such cases tight budget controls may be demotivating and ineffective. For some organizations, though, the need for predictability and control is as important as minimizing potentially dysfunctional behavioural effects of budget controls (Hartmann, 2000; Van der Stede, 2000). Public sector organizations facing political and institutional pressure for budget compliance is such an example. Testing hypotheses about the appropriateness (performance effects) of tight budget control in a public sector setting thus contributes to our understanding of the importance of tight controls for cases where predictability and control is an important control problem.

Next we review the accounting and control literature on the relationship between tight budget control and budget deviations in turbulent environments and propose a hypothesis on the relationship between these constructs. Then we present our sample, constructs, and measurements. In the penultimate section, we test the hypothesis and analyse our findings. The article concludes with a discussion of its main contributions.

2. Hypothesis development

We see turbulence as the amplitude of change in the environment that an organization is resource dependent on (cf. Boyne and Meier, 2009; Boyed et al., 1993). Since we are interested in public sector organizations' adaptability to changing economic conditions, we focus on *budget turbulence*. Budget turbulence in this setting means substantial changes in available resources—the budget—from one year to the next (Boyne and Meier, 2009). The budget in public sector organizations represents the available resources for policy and services and reflects macro and micro economic environmental developments (taxes, interest rates, service fees, etc.). The aggregate effect that changes in these conditions (the environment) have for resource availability in a particular public organization is reflected in its budget.

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