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Who's the boss? The economic and behavioral implications of various characterizations of the superior in participative budgeting research

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ABSTRACT

Participative budgeting can benefit a firm by incorporating subordinates' private information into financing and operating decisions. In the managerial accounting literature, studies of participative budgeting posit superiors that range from passively committed to highly active participants, some of whom are permitted to communicate, choose compensation schemes, negotiate with subordinates, and reject budgets. This paper synthesizes and analyzes experimental research in participative budgeting with a focus on the role of the superior defined in the research design, and on how that role affects budget outcomes, subordinate behavior, and in some cases superior behavior. We demonstrate how superior type influences economic and behavioral predictions, and likewise affects budgeting outcomes and the interpretation of the results. This paper is intended to further our understanding of how superior type affects behavior in participative budgeting studies, and to facilitate the choice of superior type in future research designs.

1. Introduction

Participative budgeting is a process in which subordinates are involved in the determination of their budgets. Since subordinates are often better informed about their abilities and environmental factors than superiors, participative budgeting is a valuable tool for planning, control, and allocating resources. Specifically, subordinates can provide superiors with information that reduces uncertainty, improves production decisions, and increases profitability. However, subordinates may distort their private information to benefit themselves at the expense of the firm. Because of the importance of participative budgeting in firms and the potential for subordinates to use private information opportunistically, it is one of the most widely studied topics in managerial accounting.

Experimental research in participative budgeting typically considers settings where a superior receives a budget report and at least one subordinate makes decisions related to that report. Typically, the slack built into the budget report by the subordinate is the primary dependent variable of interest. Since honesty is correlated with the creation of slack, it is also frequently a variable of interest.¹ Early research on participative budgeting focused on explaining subordinate behavior, and primarily used superiors who were pre-committed to a course of action. While it is valuable to understand subordinate behavior given this type of superior, other superior types can affect whether subordinates view budgeting as an ethical or strategic dilemma, and can influence whether their behavior is intrinsically or extrinsically motivated. As a consequence, researchers have begun to explore budgeting in settings with

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E-mail addresses: agbrink@vcu.edu (A.G. Brink), jennifer.coats@business.colostate.edu (J.C. Coats), bill.rankin@business.colostate.edu (F.W. Rankin).¹ In the papers discussed here, the research questions determine whether our discussion focuses on honesty, dishonesty, or budgetary slack.

superiors who are permitted to negotiate, communicate, choose compensation schemes, and reject budget proposals.

Given that the existing results from budgeting studies were obtained using a variety of superior types, in this paper we review selected experimental studies with a focus on the role of superior type.² Specifically, we discuss how superior type affects the insights and limitations of extant research and suggest how the choice of superior type can guide future research. We restrict our analysis to experimental participative budgeting studies for several reasons. First, an advantage of experimental studies is their ability to examine the causal effect of a change in a manipulated independent variable on a dependent variable, while controlling for other factors (Libby, Bloomfield, & Nelson, 2002). Also, experimental research is able to provide evidence on issues or settings where archival data may not exist or is difficult to obtain. Experimental studies also allow researchers to define the superior type and control the actions available to her. Our paper's primary focus is methodological, however: one of our objectives is to discuss how the choice of superior type in experimental designs affects subordinate behavior, and in some cases superior behavior. Hence, throughout the paper, we present both behavioral and methodological arguments as they relate to superior type. Finally, we highlight how specific characteristics of superiors could be incorporated in future experimental research as independent variable manipulations, to fill critical gaps in the participative budgeting literature.

We classify superior types into two broad categories based on whether they have a passive or active role in the budgeting process. We label these categories Committed-Passive (CP) and Participant-Active (PA). A CP superior is committed to a predetermined response to the budget proposed by the subordinate, such as accepting all budget proposals or accepting all proposals that exceed a hurdle. These passive superiors are unable to use their discretion after they receive budget proposals, so they cannot use their own criteria to reject the proposed budgets. PA refers to an experimental participant whose role depends on the decisions she is allowed to make, as determined by the experimental design. For example, this role may include superiors who can reject budgets, choose compensation schemes, negotiate budgets, and/or allocate resources.

In the CP category, we refine our identification of superior type by the frame of the superior's role in the study. Some experiments describe a hypothetical firm or superior, while other designs explicitly frame the superior as the experimenter in charge of the session. Finally, there are designs that designate other experimental participants, who cannot make autonomous decisions, as superiors. In the PA category, we organize our analysis by the actions available to the superior. These include the allocation of decision rights, the ability to commit to future actions, and the superior's use of information and communication. We argue that the framing of the superior can have a significant impact on behavioral predictions, outcomes, and the interpretation of results, as well as on the studies' external validity.

This paper contributes to the literature in three ways. First, it provides a classification of a large portion of the superior types used in participative budgeting research. It also analyzes the economic and behavioral implications of each superior type and explores how they affect the budgeting process and the interpretation of the results. Finally, we use our analysis of the role of superior type on the budgeting process to identify new research opportunities in participative budgeting, and to guide the choice of superior type in future research designs.

Although we focus on the effect of superior type in participative budgeting experiments, we believe that our analysis also contributes to other areas of managerial accounting. For instance, superior type influences economic and behavioral predictions in settings where subordinates work under various compensation schemes that, in many cases, are chosen by their superiors. Subordinate behavior in transfer pricing negotiations should be sensitive to whether the superior is represented hypothetically, by the experimenter, or by another participant. The actions available to superiors is also important in research on whistleblowing. These studies usually explore the subordinate's willingness to expose wrongdoing when the superior is hypothetical, but the wrongdoing in question is typically attributable to the superior's actions and the exposure adversely affects her. In all of these instances, manipulation of superior type should lead to a fuller understanding of the economic and behavioral issues being studied.

The remainder of the paper is organized as follows. Section 2 analyzes budgeting settings that use a CP superior, and discusses the significance of the superior frame (hypothetical, experimenter, or participant) in experiments. In the third section we describe PA superiors, and the versatile ways in which researchers have used them to address a variety of issues in budgeting. We then present future research opportunities and challenges in the fourth section. Finally, we briefly highlight our central points and provide some concluding comments in the fifth section.

2. Committed-passive (CP) superiors

In this section we classify CP superiors along two dimensions: the contract that determines their predetermined response to budgets, and how the superior is operationalized in the experiment. CP superiors' reaction to budgets (e.g., to accept all budgets or accept budgets exceeding a hurdle) is determined by the contract so they are unable to take any other course of action, such as applying their own criteria to decide whether to accept or reject budget proposals. As a result, CP superiors are particularly useful for exploring how subordinates behave under full superior commitment to an *ex ante* course of action. In this regard, CP superiors create significant experimental control by eliminating uncertainty regarding the superiors' response to budget proposals. We will discuss the economic assumptions underlying these contracts and how, in part, they determine superior type. Table 1 summarizes the studies utilizing CP superiors that are discussed in this paper.

² It is not our intention to cover all of the participative budgeting literature, but we do attempt to provide a fairly complete overview of superior types used in existing research. We chose papers that we feel make a significant contribution to the literature, and that provide good examples of particular superior types and how they affect the studies' results.

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