



CHAPTER 1

INTRODUCTION

1.1 Background of the Study

The role of budgeting process is to provide useful economic information for management planning, control, and performance evaluation to various management hierarchies. The fact that budgetary information can be used to evaluate managerial performance is instrumental to driving the evaluated managers to take actions in congruence with organizational objectives and policies. This suggests that a study concerning how to establish a framework of using budgetary information to evaluate managerial performance is worthwhile because the knowledge obtained can be used to enhance management planning and control.

The budgeting process covers broad functions from where budgets are prepared up to where budgetary information contained therein are used for management planning and control purposes. Accounting researchers have been interested in empirically investigating the issue of budget participation, i.e., how budgets are set, and the issue of budget use, i.e., how budgetary information contained therein are used to evaluate managerial performance.

There are at least two important implications from previous investigations. First, it has been suggested that the relationship between budget participation and use could potentially have impacts upon managerial performance and satisfaction (Cherrington and Cherrington, 1973; Brownell, 1982a; Dunk, 1989). Second, it

has been suggested that such relationship may be contingent upon variables related to organizational contexts, namely task uncertainty (Brownell and Hirst, 1986; Brownell and Dunk, 1991).

The relationship between budget participation and use is investigated through the principle of operand conditioning, which is concerned with the development of stimulus / response framework. In this framework, the reward structure acting as appropriate reinforcement (desired stimulus) is contended to be associated with high job performance and job satisfaction (desired responses). The stimulus is able to elicit favorable response from managers because rewards are of value to them. In an attempt to study the appropriate reward structure in the budgeting process, Cherrington and Cherrington (1973) suggest that reward structures emphasizing and de-emphasizing budget attainment can both act as appropriate reinforcement under certain conditions. Reward structure emphasizing budget attainment can act as appropriate reinforcement when managers are able to set their budgets without undue pressure from their superiors, and so does reward structure de-emphasizing budget when managers are not able to do the same.

Reward structures are considered as appropriate reinforcement if they are viewed to be fair by the evaluated managers. The fairness of reward structure is based on the relationship between budget participation and use. When managers highly participate in the setting of budgets, they perceive budgets as their own. Therefore, they feel that performance evaluation should emphasize on budgetary information that they themselves have taken part to create. On the other hand, managers do not feel increasingly compelled to have their own performance evaluated on the basis of budgetary information when they themselves do not participate as much in the setting of budgets. It is important to note that this

relationship between budget participation and use is essential to act as appropriate stimulus in order to elicit favorable responses on managerial performance and satisfaction.

The possible relationship between budget participation and use suggested by Cherrington and Cherrington (1973) motivates Brownell (1982a) to directly investigate the impacts of this relationship upon job performance and job satisfaction. Brownell (1982a) believes that the effects of how to use budgetary information to evaluate managerial performance must be studied in light of relationship between budget participation and use. In particular, it is found that high (low) budget participation and high (low) budget emphasis in performance evaluation could improve job performance, but little evidence could be found concerning job satisfaction.

It follows that the relationship between budget participation and use hypothesized and tested by Brownell (1982a) is important and should be used as a basis to classify the ways in which budgetary information are used to evaluate managerial performance. In this study, this performance evaluation approach is called budget-based performance evaluation, and is defined as the way budgetary information are used to evaluate managerial performance, given the extent of managerial participation in the setting of budgetary information.

The fact that the relationship between budget participation and use only proves effective under certain conditions is perplexing, and deserves further investigation. It is possible that such relationship may not be direct, and it could be moderated by organizational variables. Perhaps, the contingency theory of management accounting can provide further insight into such relationship. In

particular, a study by Hayes (1977) discusses this theory and emphasizes its importance to study how budgetary information are used in various ways to evaluate managerial performance contingent on organizational units facing different environments.

A number of studies have followed the contingency framework of management accounting, and have found support for the importance of organizational variables in the setting and use of budgeting systems such as organizational size (Swieringa and Moncur, 1972; Merchant, 1981), organizational structure (Bruns and Waterhouse, 1975), organizational strategy (Govindarajan and Gupta, 1985), and organizational design (Kaplan and Mackey, 1992).

One noted study that has a major implication to this study is that of Merchant (1981), which directly addresses the importance of organizational variables in budgeting system. He draws upon the contingency framework to investigate the design and use of budgeting system, and is able to demonstrate the relationship between budget participation and use in varied organizational contexts. In particular, his findings reveal that a formal control approach gains increased importance as organizations grow bigger and become more decentralized. In such situations, formal control mechanisms are required because they involve enlarged and complex chain of command. This is also consistent with the previous conclusion of Bruns and Waterhouse (1975). This approach is also called administrative control approach, which involves among other things, the following budget characteristics:

1. High budget participation
2. High budget use in performance evaluation

The other approach is called interpersonal control approach, which is suitable for small and less decentralized organizations. This rather informal approach involves among other things, the following budget characteristics:

1. Low budget participation
2. Low budget use in performance evaluation

Based upon the importance of organizational variables suggested by the previous contingency studies above, it is possible that firm size and firm ownership-management (henceforward firm ownership) may affect the impact of budget-based performance evaluation on job performance and job satisfaction. The two organizational variables are believed to affect the way in which firms decentralize their decision-making authority in management hierarchy, and this decentralization could affect the way in which budget-based performance evaluation is used.

Organizational theory suggests that there may be relationship between decentralization of decision-making authority and firm size (Hall, 1977; Robbins, 1990). Large firms are impossible to be fully controlled from the top management because there are a great deal of asymmetry of information among management hierarchies. This inevitably calls for delegation of decision-making authority to those having more information. A number of studies (Blau, 1972; Hickson, Pugh, and Pheysey, 1969; Pugh, Hickson, Hinings, and Turner, 1969) have provided empirical support that large and small firms have different patterns of decentralization of decision-making authority. Large firms tend to be more decentralized, and small firms tend to be less decentralized.

Another organizational variable, firm ownership, is also believed to affect decentralization of decision-making authority. In reviewing the literature, Robbins (1990) suggests that relationship between decentralization and firm size may depend upon the degree to which owners control and manage the firm. As firms become larger, there could be less decentralization of decision-making authority in owner-managed firms than in professional-managed firms because owner-managers are less willing to share control with others. In fact, a study by Geeraerts (1984) has directly investigated and found support for this line of thought. Results show that there is positive relationship between changes in firm size and changes in firm structure (i.e. decentralization) among professional-managed firms; no such relationship is found among owner-managed firms.

It could be inferred from the discussion above that the effectiveness of control mechanisms, such as budget-based performance evaluation, could be dependent upon firm size and firm ownership. This is to suggest that the effect of budget-based performance evaluation could be different between:

1. Large and small firms
2. Owner-managed and professional-managed firms

To summarize, there are no definite answers pertaining to relationship between budget participation and use. Such relationship is hypothesized and tested by Brownell (1982a) to have a positive impact on job performance and job satisfaction. However, empirical results only support the positive impact on job performance. Moreover, later studies have not been able to confirm the positive impact on job performance. Brownell and Hirst (1986) report that such relationship have no impact, and Dunk (1989) even reports negative impact.

But, even if there are definite answers to relationship between budget participation and use in the extant literature, it is possible that such relationship may vary differently in various cultures (Harrison, 1992). In other words, the impacts of budget-based performance evaluation documented in Western countries may be found to be different in Thailand. Therefore, it is a worthwhile endeavor to conduct this study in Thailand to analyze whether empirical results in budgeting research conducted in Western countries will apply to Thailand.

1.2 Purpose of the Study

The purpose of this study is two-fold. First, it is to investigate the impacts of budget-based performance evaluation styles upon job performance and job satisfaction. The term adopted in this study refers to the relationship between budget participation and use, and is classified as follows:

1. Congruence style
2. Incongruence style

Congruence style refers to the situations whereby 1) managers **highly** participate in the formulation of budget goals, and there is **high** emphasis on budget goals to evaluate their performance, or 2) managers **do not highly** participate in the formulation of budget goals, and there is **low** emphasis on budget goals to evaluate their performance.

Incongruence style refers to the situations whereby 1) managers **highly** participate in the formulation of budget goals, and there is **low** emphasis on budget goals to evaluate their performance, or 2) managers **do not highly** participate in the formulation of budget goals, and there is **high** emphasis on budget goals to evaluate their performance.

The second purpose is to use the contingency framework to investigate whether the impacts of budget-based performance evaluation are different according to varied organizational contexts in which it is used. A review of contingency framework suggests that firm size and firm ownership may be important moderating factors, which explain the impacts of budget-based performance evaluation upon job performance and satisfaction. Therefore, the two organizational variables are introduced into this study.

1.3 Statement of the Problem

It is discussed in the background of the study that relationship between budget participation and use, which gives rise to budget-based performance evaluation, could affect job performance and job satisfaction. It is also further discussed that this contention could be moderated by contingent variables. However, results are less than conclusive. For job performance results, it is found to have a positive impact (Brownell, 1982a), no impact (Brownell and Hirst, 1986), and negative impact (Dunk, 1989). For job satisfaction results, it is not conclusive (Brownell, 1982a). Therefore, further investigation is warranted. The two major research questions can be phrased as follows:

1. Are there significant difference in job performance between the styles of budget-based performance evaluation? If so, do the differences vary according to firm size and/or firm ownership?

2. Are there significant difference in job satisfaction between the styles of budget-based performance evaluation? If so, do the differences vary according to firm size and/or firm ownership?

It is thought to be beneficial if the two research questions are examined in the Thai banking industry for the following reasons. First, the banking industry is probably among the most significant industry in Thai economy, and results from this industry may be more far-reaching in terms of setting examples for other industries. Second, the banking industry is service-oriented, which has a relatively limited number of research compared to other industrial sectors such as the manufacturing industry. Third, the banking industry is known to have used widespread budgeting systems, which create sufficient data base for investigation.

This study is therefore set to examine the impact of the two styles of budget-based performance evaluation on job performance and job satisfaction in the Thai banking industry. The two are congruence and incongruence styles. Moreover, this study is to further examine if the impact are different when the Thai banks are partitioned into groups based upon firm size and firm ownership.

1.4 Statement of the Hypotheses

This study is undertaken to answer two related research questions. The first research question consists of three hypotheses, all related to job performance. The second research question also consists of three hypotheses and is similar to the first, except that it is related to job satisfaction. In order to study the two major research questions, the null hypotheses are formulated as follows:

Hypotheses Related to Job Performance

Hypothesis 1.1 : There are no significant differences in job performance between the two styles of budget-based performance evaluation.

Hypothesis 1.2 : There are no significant differences in job performance between the two styles of budget-based performance evaluation in large and small banks.

Hypothesis 1.3 : There are no significant differences in job performance between the two styles of budget-based performance evaluation in owner-managed and professional managed banks.

Hypotheses Related to Job Satisfaction

Hypothesis 2.1 : There are no significant differences in job satisfaction between the two styles of budget-based performance evaluation.

Hypothesis 2.2 : There are no significant differences in job satisfaction between the two styles of budget-based performance evaluation in large and small banks.

Hypothesis 2.3 : There are no significant differences in job satisfaction between the two styles of budget-based performance evaluation in owner-managed and professional managed banks.

1.5 Definitions of Key Terminology

This section explains the definitions of three major variables:

1. Budget-based performance evaluation
2. Job performance
3. Job satisfaction

Budget-Based Performance Evaluation

Budget-based performance evaluation refers to the way in which budgetary information are used to evaluate managerial performance (budget use), and the way in which the evaluated managers are allowed to participate in the setting of budgetary information (budget participation). In this study, it is classified into congruence and incongruence styles.

Job Performance

Job performance refers to the managerial ability to accomplish the various management functions.

Job Satisfaction

Job satisfaction refers to a pleasurable or positive emotional state resulting from the appraisal of one's job or job experience (Locke, 1976).

1.6 Scope and Limitations of the Study

The scope of this study is concerned with data collected from the branch managers of the selected Thai commercial banks in order to investigate the impact of budget-based performance evaluation on job performance and job satisfaction. Therefore, it should be emphasized that the findings may merely apply to the population studied, which is represented as the Thai commercial banks. As a result, they may not be readily generalizable to other financial institutions and industries in Thailand.

The generalizability of the findings of the study could be further limited. First, the concepts of the research instruments are developed based upon previous literature in the West, and, therefore, may not be readily applied to measure the key variables of interest in Thailand. In addition, there could be potential problem associated with translation of the research instruments. Follows is the brief description of the scope of the key variables examined in this study.

Budget participation in this study is concerned with the way in which there are both involvement and influence in the setting of the three types of budgets. The three types of budgets are identified as loan, deposits, and expense budgets.

Budget use in this study is concerned with the way in which budgetary information are used in performance evaluation. In particular, an attempt is made to distinguish whether performance evaluation is based upon the ability to meet budgets or the efficiency of branch operations.

The overall effectiveness of job performance as well as eight individual aspects of job performance are examined in this study. The eight aspects include planning, investigating, coordinating, evaluating, supervising, staffing, negotiating, and representing.

The overall job satisfaction is examined in this study. In particular, the concern is on the general aspect of job satisfaction rather than the individual aspects of job satisfaction.

1.7 Organization of the Study

This study is composed of five chapters. Chapter 1 deals with the introduction, the rationale of the study, the research problem, the definitions of key terminology, the scope and limitations of the study, and the organization of the study.

Chapter 2 investigates prior significant research works concerning budget-based performance evaluation from related literature in accounting, organization, and psychology. It begins with the discussion of the budget-based performance evaluation in the universalistic framework. However, an emphasis is given to the discussion of the contingency theory of management accounting that serves as a framework to better understand the effectiveness of budget-based performance evaluation.

Chapter 3 discusses the research methodology. It first discusses the sampling procedures, which includes the identification of population and sampling frame. It then discusses the design of data collection procedures, research instruments, and data analysis.

Chapter 4 first reports the characteristics of the responses, and the general statistics of the independent and dependent variables. It then reports empirical results and discusses them in the context of the proposed hypotheses.

Chapter 5 summarizes and concludes the study. In addition, it also makes some recommendations for future research.