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Budgeting, the individual and the capital market: A case of fiscal stress

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Abstract

Budgetary control is a major aspect of management control. It has undergone major shifts of emphasis in both the literature and practice in the later part of the 20th century. A significant influence on the changing practices of this aspect of control has been the growth of and increased influence of the capital market. This paper draws on a detailed field study focusing on the problematic nature of budgetary control in a changing operational environment that acknowledges both the importance, internally, of the organisation members and their contribution to continued growth—and externally the growing influence of shareholders on business operations. The focus of the paper is on the effects of the constant pressure of the share price on the case unit of analysis and how that changed the use of the budgetary control system. This change is illustrated both at a macro level of organisational accountability for predicted results and also as it is driven down the organisation to the level of the individual.

Keywords: Capital market; Budgetary control; Management control; Accountability; Shareholders; The individual

1. Introduction

The objective of this paper is to explore the relationship between organisational budgetary control and the capital market. The paper describes the changing relationship between the capital market and corporations and focuses on the effects that this changing relationship has had on the operation of organisation control through the use of a budgetary system.

The capital market is broadly defined here as the market, or markets, where investment products such as stocks and bonds are bought and sold and commonly referred to as the stock market. Historically firms have focused on the product market from where they derived their revenue through sales of their products or services. Although the two markets are theoretically separate, they have increasingly become mutually dependent with firms having to be successful in mediating their position within both markets. In other words, firms have to be good at not only producing

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and selling goods and services but also at managing their relationship with their shareholders. Capital market investors demand returns measured by levels of increasing shareholder value. The field-study based case study described and analysed in this paper shows that the firm level accountability for increasing returns is moving increasingly down the organisation to the level of the individual by means of a changing control environment illustrated in this paper through the workings of a budgetary control system.

The influence of the capital market on budget implementation is considered in this paper within a case study context of a particular organisation, referred to as Eurel. This is done by connecting the world of the capital market with that of the organisation to show the changing influence on and changing practices of budgetary control. The paper is located within a discussion of key work on budgetary control particularly in the areas of participation, slack, performance measurement, time frames and bias (Argyris, 1952; Hofstede, 1968; Hopwood, 1972; Likert, 1961; Llewellyn, 1998; Lowe & Shaw, 1968; Schiff & Lewin, 1970; Van der Stede, 2000). All of these issues were relevant to Eurel and its organisation members.[1]

The capital market has impacted on corporations through changing expectations focussing especially on expected performance and growth issues. In recent years, shortening product life cycles and increased competition has meant that sales and profit growth has been difficult to maintain often resulting in a shortfall between actual results versus those predicted. The demand for organisational credibility in the attainment of results has been led especially by institutional shareholders, who no longer show a loyalty to the companies in which they invest (Drucker, 1999; Handy, 1995; Rappaport, 1986).

The movement from individual ownership to larger fund management groups has lead to changes in shareholder priorities (Handy, 1995). The growth in fund management has institutionalised share dealing and ownership (Froud, Johal, & Leaver, 2006). The traditional holding of shares has increasingly been delegated to the fund management community who along with the investment analysts (for example the Wall Street analysts), exercise major steering power and influence over organisations and their strategies. Much of this has been enabled by the ever more remote separation of ownership and the growth in management of international share portfolios (Drucker, 1999; Handy, 2002). Institutional shareholders (pension funds, private equity funds, and so forth) have had an increasing policy of engaging in what has been described as the active management of funds rather than the previously more common practice of long-term share ownership. Rappaport (1986) notes that portfolio managers compete for best returns by moving in and out of individual stocks with the possible consequence that this is not necessarily based on a company's long-term future goals but on short-term return expectations for shareholders. Institutional investors are increasingly willing to intervene in the affairs of organisations and can influence the manner in which managers carry out their duties. They can influence for example the expectations as to what constitutes a fair return on funds invested and the time frame in which it is expected. Historically, share ownership was more dispersed with the result that there were limits to the boundary of impact that individual owners could make (Berle & Means, 1968; Froud et al., 2006).

2. Overview of the paper

The paper starts with a review of the essence of budgetary control with a focus on the issues of participation, slack, measurement, time frames and bias. This section also signals and integrates

[1] In some legal regimes the term 'members' refers to shareholders. Here it means the employees, managerial and other.