Budgeting and innovation
Complements or contradictions?
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Budgets and innovation have long been viewed as antithetical. Budgets encourage cautiousness and risk-averseness, while innovation demands creativity and risk-taking. However, an increasingly globalised economy demands that firms achieve both simultaneously. So, how is this being attempted? How are firms seeking to reconcile the twin but supposedly incompatible imperatives of budgetary control and creative innovation? The purpose of the project was to provide some insight into this issue. Specifically, the study aimed (1) to look at the control processes that might be involved in reconciling budgeting and innovation, and (2) to document and understand the issues that might arise therefrom. The study was motivated by CIMA’s central interests in understanding ‘… how traditional budgeting is being altered to meet the contemporary demands of the business world’ (CIMA Research Opportunity, 2001).

To address the research questions, an in-depth analysis was undertaken of the budgetary procedures and innovative processes of Astoria plc, a multinational organisation and a leading player in the global technology sector. The field-based methodology was dictated by the lack of prior research into the interplay between budgets and innovation. For the purposes of this study, innovation is defined as: ‘The application of new or different approaches or methods or technologies to meet organisational objectives’ (Schroeder et al., 1989: 6).

The focus on a single organisation as the research site enabled a deeper level of analysis than is normally possible through cross-sectional surveys or when multiple field investigations are undertaken simultaneously. The exploration of the budgeting-innovation interplay through this in-depth case study approach produced the following research findings.

Executive summary

First, evidence suggests that budgets may be embedded within a wider management control framework as a means of addressing formally the interplay between budgets and innovation. This approach enables conflict resolution at the interface between budgets and innovation. Managers were observed to combine formal procedures with more informal social interactions in their bid to micro-manage tensions arising between budgetary control and creative innovation. A fundamental aspect of this micro-managing was the ability to reallocate resources and funds through discussion and negotiation both within and across functions in the light of unfolding circumstances.

Second, and in contrast to received wisdom, it appears that budgetary control may be exercised in broadly traditional ways without hitherto hindering innovation within the firm. The principal difference to traditional systems observed at the research site was the use of what we have termed ‘aggregated variance analysis’. This, however, enabled managers to manage flexibly and responsively within the overall discipline of traditional budgetary controls. These findings challenge the Beyond Budgeting debate, which advocates the demise of budgets on the grounds that budgetary systems deter innovation and learning.

Third, whilst ‘beliefs systems’ and similar value systems may have become commonplace as a way of prescribing the pursuit of innovation (Simons, 1995), these management control systems may not be sufficient to ensure innovation occurs. Rather, the key to securing managers’ involvement in innovative activity appears to be empowerment.

Finally, the study suggests that, as well as formal controls, social interactions are crucial to managing the absence of individual-level controllability which is created in the pursuit of innovation. Rather than being concerned by their dependence on others, managers appear to relish the challenge of the situation. This finding also has implications for the Beyond Budgeting debate. The study’s wider implications are discussed in the concluding section of this report.
1. Introduction

Budgets and innovation have long been viewed as antithetical. On the one hand, budgets are about efficiency, cost control, variance correction, and target achievement. They are accused of encouraging stability, individualism and risk-averseness. On the other hand, innovation in organisations emphasises experimentation (with the concomitant possibility of budget 'failure'), initiative, and creativity, and thereby depends upon behaviours such as cooperation, risk-taking, and an acceptance of change. Formal definitions of innovation stress the application of new or different approaches and technologies to meet organisational objectives (e.g. Schroeder et al., 1989).

Given the evident differences between budgets and innovation, reconciling the two appears problematic. Yet, an increasingly globalised economy demands that both are achievable simultaneously. Fiercely competitive markets demand tight cost control in order to maintain profit margins, while a fast-moving and dynamic environment stresses the need for a high rate of strategic adaptation and change.

Funded by CIMA, and informed by a management control perspective, the research reported here sought to provide some preliminary insight into how the inherent tensions between budgets and innovation may be reconciled within the firm. The research aims were twofold: to look at the control processes that might be involved, and to document and understand the issues that might arise. The specific questions the present study sought to address included the following:

a) How far and in what ways tensions between budgets and innovation are addressed within a framework of management control.

b) How far and in what ways innovation is accommodated through changes to the design and operation of budgetary systems, as is implied by the Beyond Budgeting debate (e.g. Hope and Fraser, 1997).

c) How far and in what ways innovation, which implies the need for flexibility, together with a degree of inefficiency and occasional 'failure', is accommodated within the management control process.

d) How far and in what ways budgets may inhibit the development of new ideas and initiatives.

The focus of the research is given added impetus by recent organisational developments. While many of these such as the use of network structures, multifunctional project teams, the pursuit of empowerment initiatives, and horizontal communications, are aimed at supporting innovation and learning, they also problematise the controllability principle on which traditional budgeting is founded (Choudhury, 1986). Instead of having full control over his or her budget, the individual manager must contend with partial controllability. To this end, the project will explore how far and in what ways managers address the issue of controllability, as part of the analysis of the interplay between budgets and innovation.

The study’s aims were addressed through an intensive field investigation of a multinational organisation, which has been called Astoria to preserve its anonymity. Pertinent company background information, including Astoria’s business operations, size, and organisational configuration, is provided in Chapter three. Chapter three also describes the study’s data collection and analysis procedures. For now, the rationale for employing the case study method of empirical enquiry in the present analysis will be explained.

The choice of case study approach was dictated by several factors. First, exploratory field research is essential in ‘new’ areas such as this, which lack an extant body of both theory and data (Noda and Bower, 1996). Second, qualitative studies are necessary where organisational processes, such as the interplay between budgeting and innovation, which do not lend themselves easily to quantitative measurement, are involved. Third, in view of the subject matter, there is a need to ‘get inside’ an organisation in order to observe the dynamics of the relationship between budgeting and innovation. Finally, the use of single site exploratory case research enables the micro analysis of budgeting and innovation. In the event, the case study company provided a valuable research site for the present investigation, not least because of the insights gained into the interplay between budgets and innovation. To foreshadow the discussions to follow, the main findings, implications and recommendations are outlined here. There are four issues to discuss.
First, evidence from the study suggests that the embedding of budgets within a wider management control framework is integral to dealing with tensions arising between budgetary control, on the one hand, and creative innovation on the other. Findings also suggest that managers are willing to utilise formal control procedures along with more informal social interactions in a bid to micro-manage the budgeting-innovation interplay. The marrying of the formal with the informal highlights how management controls may play a positive role in managers’ work-related experiences. Rather than seeing formal controls as ‘getting in the way’, managers may welcome their existence for reconciling tensions arising at the interface between budgets and innovation. A broader control framework incorporating the budgetary system appears crucial to helping managers work through the processes of strategic adaptation and change.

Second, the study found little evidence of changes being made to the design and operation of the budgetary system to accommodate the pursuit of innovation and learning. However, there were two substantive differences between Astoria’s budgetary process and traditional budgetary systems. First, managers were able, through discussion and negotiation both within and across functions, to reallocate resources and funds. The second is what we have termed ‘aggregated variance analysis’. Both greatly enhanced managers’ capacity to manage flexibly and responsively to events and developments as they occurred. The process of aggregated variance analysis essentially involves analysing budget variances, not in isolation at the level of the individual responsibility centre, but in relation to company strategy. To this end, aggregated variance analysis depends upon managers having a clear understanding of company strategy. Informed by this understanding, managers at Astoria could (and would) make resourcing decisions (e.g. re-allocation of funds) which promoted the achievement of organisational objectives. This prioritises the organisation’s top-level goals over individual responsibility centre targets.

Notwithstanding the above, the study found little evidence of differences in budgetary practices to traditional budgetary systems. More importantly, perhaps, the study found no evidence to suggest that budgeting at Astoria deterred innovation. This finding holds implications for the Beyond Budgeting debate. Recent calls for the demise of budgeting are grounded in the view that budgets are at best inappropriate, and at worst potentially harmful to organisations in the information age (e.g. Hope and Fraser, 1997; 2003). The results of this study suggest that this view may be overemphasised and potentially misplaced.

A third insight gained by the present research concerns the importance of empowerment to securing positive attitudes towards innovation. Simons (1999) argues for the use of systems such as ‘beliefs systems’ in order to ‘inspire’ and guide the search for new ideas and initiatives. Findings from the present study broadly support this contention, in that much emphasis was made at Astoria of the need to imbue managers with an understanding of organisational purpose, aims and objectives, so that this understanding could inform day-to-day decision-making and the search for new ideas and initiatives. However, our findings also suggest that this may only be half the story. Beliefs systems may be necessary but not sufficient to ensure innovation. Empowerment initiatives may also be required. Astoria’s managers were at pains to point out that, while they may have understood ‘what the organisation was about’, it was empowerment that facilitated the search for new or different approaches or methods or technologies. In this context, an understanding of company strategy may provide the necessary ‘background information’ as to the direction any innovation should take. But, it is the experience of empowerment that actually prompts the innovative activity.

Finally, the study corroborates the view that organisational arrangements such as internal networking, horizontal communications, and empowerment initiatives serve to undermine individual-level controllability. The lack of formal controllability over budgets was evident in the extent to which managers at Astoria had to rely upon others ‘doing their bit’ in order that they could discharge their own accountabilities. However, contrary to received wisdom, this situation does not appear to be viewed in negative terms. Rather, evidence suggests that managers approach the fact of partial controllability with a positive attitude, seeing it as a challenge to be managed as part of their role. The challenge was managed through communication and social interactions, the purpose of which was to develop a shared understanding as to how goals may be achieved. Managers appeared to gain at least a perception of control through these social interactions. This fourth aspect of the study has implications for the design and operation of budgetary systems. Findings suggest that, in contrast to what has been written about budgets, the individualistic nature of traditional budgeting may actually encourage rather than discourage managerial cooperation, as managers seek to manage recognised interdependencies and partial controllability through dialogue and discussion.
1.1 Suggestions
On the basis of the findings outlined above, the following suggestions are presented:

The study suggests that budgetary systems designers focus their attention on budget setting and the question of variance analysis, rather than on the distribution of controllability within the firm. Although budget setting and variance analysis are normally linked to controllability through performance evaluation and reward, it appears from the present analysis that the crucial issue for firms facing the twin task of ensuring cost control alongside ‘creative innovation’ is how to secure the best use of resources relative to the overall strategic needs of the firm. In this context, issues such as partial controllability are perceived as secondary to ensuring that the financial decisions taken support the company’s overall strategy. This process seems to be aided through an emphasis on ‘shared accountabilities’ and ‘aggregate variance analysis’.

Related to the above, senior executives and accounting practitioners may wish to consider the form and content of the overall management control framework, particularly the ways in which a variety of controls including budgetary control can be combined together into a coherent whole. While some of the control processes observed at the research site may be organisation-specific, it was particularly revealing that managers would, without hesitation it seems, utilise the controls available in order to reconcile tensions arising between the pursuit of budgetary control on the one hand, and the pursuit of innovation and learning on the other.

Overall, it is stressed that more research is needed into how firms seek to reconcile the activities of budgeting and innovation. Although the demise of traditional budgets is advocated by some (e.g. Hope and Fraser, 1997; 2003), and while there is anecdotal evidence to suggest that a few firms may have dismantled the budget, survey evidence suggests that the vast majority of firms continue to operate some form of budgetary control. But, what is little understood as yet, is how budgeting is performed in the context of innovation and learning, or how innovation and learning is achieved in the context of budgeting.
2. Survey of relevant related work

Financial control remains an organisational imperative. An inability to control costs and achieve desired financial performance jeopardises the long-term survival of the firm, particularly when competition is fierce (Merchant, 1998). Equally, contemporary organisations have increasingly emphasised the importance of innovation and learning, which imply ‘first-time’ activities and frequent modifications and changes to these activities, to their future competitive success (Mintzberg, 1987). This creates difficulties for both resource allocation and the monitoring of budgetary performance. Problems arise, not least because budgets lack a body of historical data on which to base budget predictions when new activities are undertaken (Otley, 1999). Moreover, a high degree of uncertainty surrounding budget predictions presents problems for the monitoring of performance as the budgetary period unfolds. Should, for example, the focus be on maintaining progress towards initial budgetary targets, or should modifications to projects and activities be funded as they arise in order to enhance the likelihood of their eventual success?

The issues and tensions created by a fast-moving and innovative environment in relation to the role of budgets and other accounting controls are recognised in the practitioner literature. Several articles in the 1990s criticised the budget for being unable to meet the demands of the competitive environment in the information age (Hope and Fraser, 1999). Eye-catching titles relating to this theme have included ‘Is it time to replace traditional budgeting?’ (Schmidt, 1992), ‘Out with the old, in with the new’ (Newing, 1994a), ‘The budget – an unnecessary evil’ (Wallander, 1999), and ‘Bye bye budget...the annual budget is dead’ (Gurton, 1999). These criticisms have received backing through the work of the Consortium for Advanced Manufacturing – International (CAM-I), which has been concerned with documenting the modifications that organisations are introducing to their budgetary systems in the light of an increasing emphasis on innovation within the firm. At the same time, however, such work is largely concerned with identifying ‘best practice’, and provides little insight into the rationale for any budgetary modifications encountered, or the issues and problems that arise from operating with modified budgetary systems. More importantly, this work fails to address the question of how the interplay between budgeting and innovation is managed in practice.

Consultants Hope and Fraser (1997; 2003) have taken the criticism of budgets a step further. They advocate the demise of traditional budgetary systems on the grounds that such systems are a barrier to the changes required to compete in the new ‘information age’. They argue that the new management techniques, which have been developed in response to the changing environment, can not be successfully implemented when management behaviour is ‘snapped back’ into its old shape by the invisible power of the budget. Hope and Fraser (1997, 2003) also provide anecdotal evidence to suggest that a number of large European and American companies have dismantled the budget or intend to do so.

Interesting as this work is, recent survey evidence suggests that the vast majority of firms are continuing to operate with some form of budgetary control (e.g. Vuorinen, 2004). This, of course, is to be expected, as setting financial objectives and measuring performance towards their achievement remains fundamental to firm survival. At the same time, it returns us to the focus of the present research, which is how then are budgets being reconciled with the pursuit of innovation and learning? The issue calls for in-depth analysis. In the academic literature, however, research into the impact that changing organisational circumstances and an increasing need to innovate may have on budgeting within the firm, has progressed little beyond conceptual debate on the likely future role of accounting systems such as budgets as a tool of management control. Otley (1994), for example, has argued that, whilst firms will continue to need systems of management control, accounting is likely to play a more peripheral role than is currently appreciated in the literature. His comments are grounded in three organisational developments that appear to problematise the role of accounting as a tool of management control. These are increasing uncertainty, a decline in large manufacturing organisations, and the trend towards co-operative, group-based management practices, which are aimed at facilitating creative innovation. However, Otley offers few suggestions as to the likely make-up of future financial control mechanisms and processes, nor does he suggest how these systems might operate in the context of a high emphasis on innovation and learning. Others see a role for accounting and budgets as part of a ‘control package’ aimed at controlling various aspects of the strategy process and managing the tension between creative innovation and cost control. In this context, accounting controls may be used diagnostically in order to ‘limit innovative excess’ (Dent, 1990; Simons, 1995, 1999), or used interactively to stimulate creative activity in areas of strategic uncertainty (Simons, 1999). Again however, whilst Simons’ work is pioneering, he provides little insight into how the financial control system may be designed and operated as part of a wider management control system which is aimed at managing the tension between innovation and predictable goal achievement. Hope and Fraser (1997; 2003) take a more extreme view, arguing for the demise of budgetary systems on the basis that such systems are inappropriate for the modern business climate. Their arguments are grounded in the view that budgets and innovation are antithetical. While their response to this involves an emphasis on enabling resource mobility in support of innovative activity at the level of the individual responsibility centre, the authors omit to discuss how the imperative of financial control is then reconciled across the broader organisation.
In bringing attention to the possible future role of accounting within the new ‘innovative organisational order’, recent arguments are echoing earlier concerns expressed by several contingency theorists. As early as 1979, for example, Ansari was arguing that ‘...new developments in organisational forms and management systems require changes in the design of many MIS to make the functioning of the overall control system more effective’ (Ansari, 1979: p149). He concluded that, as the nature of organisational change reflects an ‘open’ systems philosophy (i.e. one which, unlike a ‘closed’ system, does not deny the impact of external factors), budget variance analysis should likewise reflect this open systems approach. McNally (1980) has argued for a change to the way controllability is distributed in order that such distribution more closely reflects the greater interdependence that innovation brings. His argument is that the notion of ‘shared responsibility’ needs to be addressed by modern responsibility accounting systems if these are to accommodate the needs of the modern enterprise. Several others (e.g. Hedberg and Jonsson, 1978) have suggested changes to the design of management information systems, including the budgetary system, in order to avoid the ‘problems’ of inertia and stability that are normally associated with them. Again, however, little indication is given as to the form these changes may take or indeed how they may accommodate the competing needs of exercising financial control and facilitating innovation and learning.

Not only has the interplay between budgets and innovation received little conceptual analysis, there is virtually no empirical evidence on this subject. One exception is Marginson’s (1999) study of a major UK firm which exhibited many of the characteristics of contemporary organisational structures. Marginson found that the firm had introduced several major changes to the manner in which financial control was affected. These included the removal of formal accountability for financial performance from all but the most senior management level, the inclusion of accountants in management meetings to inform managers on the financial implications of their actions, and the use of ‘cost crusades’ as a means of reinforcing the message of cost control. In effect, financial control had become a ‘softer’ process, in which management accountants were more closely involved as ‘team players’, but formal accounting information played little part, particularly below the level of senior management. Interestingly, accountability for the firm’s overall financial performance appeared to lie primarily with the financial controller and his subordinates.

Many of these changes were made to encourage greater creativity and innovation across all levels of the firm. However, whilst Marginson (1999) highlights several interesting developments in this regard, further research is required, both to extend our understanding of budget objectives and structures of financial controls, and to develop a theoretical perspective on the interplay between budgets and innovation. The following chapter seeks to explain how this was undertaken in the present analysis.
3. Research plan

It is possible to cluster the issues raised in chapter 2 into four conceptual groupings for consideration and analysis. The first of these may be described as the management control framework. Recent research suggests that creative innovation may be subject to top management influence through the use of a ‘package’ of control systems. This package might include ‘beliefs (value) systems’, ‘boundary systems’, ‘interactive control systems’, and ‘diagnostic control systems’ (e.g. Simons, 1995; 1999). It is expected that such a package of controls will establish ‘fruitful dynamic tensions’ or countervailing forces to ensure that managers have the freedom to innovate, whilst at the same time, working productively towards achieving pre-determined goals and objectives (Simons, 1995). Nevertheless, however, extant research provides little insight into how a firm’s management controls may be used by those below senior management levels to deal with the budgeting-innovation interplay. The present study investigates the extent to which management controls are being designed to explicitly address the tensions that may arise through such interplay. It also addresses the extent to which managers may actually use these control processes for the purposes of managing the tensions that inevitably arise from pursuing what are often seen as competing objectives. This is consistent with extant research in accounting which demonstrates the need to consider both the design and use of management control systems.

A second conceptual element of the interplay between budgets and innovation relates to the design and operation of the budgetary system. Recent arguments emphasise the need, as a minimum, to re-design the budgetary system in line with contemporary organisational needs (e.g. Otley, 1994; 1999). A particular problem concerns the issue of budget variances. Traditional budgetary systems are modelled on the notion of negative feedback, which means that variance correction should follow automatically from the information received (Ansari, 1979). To this end, traditional budgetary systems make no allowance for the uncertainty of task or role interdependence (Ansari, 1979). This is because the presence of these conditions compromises the binary division of controllability (full/no control) which underpins responsibility accounting (McNally, 1980). In these conditions, no single manager is able to exert full control over the financial results for which formal accountability has been established. But, these are precisely the conditions that are created by the pursuit of innovation and learning. Given this, it is important to consider how managers attempt to cope with partial controllability, not least because the controllability principle itself has been linked to non-cooperation and risk averseness (Hopwood, 1972), behaviours which are the anathema of innovation and learning.

Given issues such as these, it is important to examine how budget variance analysis is conducted in the context of innovation, or how creative innovation is pursued in the context of budget variance analysis. As part of this analysis, the study explores the extent to which this level of the budgeting-innovation interplay may involve changes to the design of the budgetary system, and if it does, what these changes are. The comparator will be the model of budgeting as depicted by Ansari (1979), as this model provides a reasonable approximation of the type of traditional budgetary system that has more or less endured to this day.

Budgets are deemed to deter innovation and learning, a view which invokes consideration of managers’ views on the interplay between budgetary control and innovation. This third element of the study’s conceptual framework explores how managers approach the subject of innovation in the context of their budget responsibilities. It is important to investigate the behavioural effects of budgeting in the context of innovation as it holds implications for issues such as morale and personnel retention. In a time when ‘intellectual capital’ is highly valued, the crucial people within a firm are often the ‘entrepreneurs’ (Bartlett and Ghoshal, 1993). It is they who ‘move the company forward’ through their ‘creative thinking’ and innovative activity. At the same time, it is they who may feel most constrained and restricted by budgets and cost control. Consequently, the study seeks to explore the views and opinions of the ‘primary initiators of entrepreneurial activity’ (Bartlett and Ghoshal, 1993).

The fourth and final research strand concerns the controllability principle. Both traditional organisation theory (House and Rizzo, 1970) and the concept of responsibility accounting are grounded in the notion that the manager should not be held accountable for that which s/he cannot control. But it is only possible to uphold this principle in a work environment which is bereft of general uncertainty and of task or role interdependence (Ansari, 1979). This is because the presence of these conditions compromises the binary division of controllability (full/no control) which underpins responsibility accounting (McNally, 1980). In these conditions, no single manager is able to exert full control over the financial results for which formal accountability has been established. But, these are precisely the conditions that are created by the pursuit of innovation and learning. Given this, it is important to consider how managers attempt to cope with partial controllability, not least because the controllability principle itself has been linked to non-cooperation and risk averseness (Hopwood, 1972), behaviours which are the anathema of innovation and learning.
The case study on which this project is based involved an in-depth investigation of Astoria plc., a multinational organisation and a leading player in the global technology sector. The rationale for a case study approach has been outlined in the opening chapter. The aim in this chapter is to present pertinent background material and to describe the study’s data collection and analysis procedures. The chapter begins with company background.

**4.1 Company background**

Astoria operates in a highly competitive, global technology-based market place, which is characterised by rapid technological change, short product lifecycles and high levels of uncertainty. To compete on a global basis, the company operates from a number of sites throughout the world. These are situated in both developed and developing countries. However, the company’s primary location is the US, with 62% of revenue in 2002 ($9.9 billion) emanating from this market alone. The company currently employs approximately 60,000 people worldwide.

The case study company exhibits many contemporary organisational characteristics. These include a highly ‘organic’ configuration and a relatively flat organisational structure. This structure is matrix based, which means that the company operates with a significant amount of cross-functional dependency in support of multiple ‘boundary-spanning’ activities. Formally, the company is organised along two dimensions: functional specialism and geographical location. Functional specialisms are divided into four groups: research technology and intellectual property; business operations; customer operations; and operations support. Geographically, the company is defined in terms of its three major markets: North America, Europe and Developing Markets.

**4.2 Data collection and analysis**

Preliminary investigations involved interviews and re-interviews with two of Astoria’s senior managers who were responsible for implementing the management control framework across the European arm of the company’s global activities. This pilot stage of the study also involved interviews with four managers at one of the company’s UK operations. The interviews were used to gain insight into several issues, including company strategy, company background, the firm’s budgetary processes and procedures, and other aspects of the company’s management control systems. Particular attention was paid to gaining insight into managers’ budget responsibilities, methods of performance evaluation, innovative practices, and the distribution of accountabilities within the firm.

Informed by the data gathered at this stage, a semi-directional interview protocol was developed in order to explore further the management control processes and practices in place within Astoria. Interviews were conducted with 25 managers drawn from several of the company’s functional areas, including product development, manufacturing, purchasing, supply chain and logistics, marketing, sales, human resources and finance. Interview data were triangulated with data collected from various other sources as dictated by case study protocol (Yin, 1983; 1993). These included internal company documents, internal employee survey results, archival records, research articles, and business press reports. Themes investigated and covered during interviews centred around budgets and innovation, and included: role responsibilities; budget responsibilities; target setting process; accountabilities; controllability; performance evaluation and reward; innovation and learning; and company strategy. Interviews lasted between 75 minutes and two hours 30 minutes, with a median time of approximately two hours.

Qualitative data analysis proceeded according to standard practice, following the guidelines of Miles and Huberman (1984) and Glaser and Strauss (1967; 1970). Interview data were transcribed, documented and collated, and detailed written descriptions prepared for each interview by reference to the interview themes outlined above. A form of constant comparison and cross-referencing was used to triangulate comparative data from interviews in an attempt to discern shared or conflicting views about the issues under investigation. Interview data were also cross-referenced with other data garnered from the study, while the written interview descriptions were analysed independently by the researchers involved prior to agreement being reached on the interpretation of the case study evidence. The findings to be presented represent the culmination of the study’s data collection and analysis procedures.
5. Research findings

The study’s findings will be presented by reference to the four conceptual elements that informed the present analysis.

5.1 Management control at Astoria

Astoria operates a broad framework or package of management controls, which includes particular control mechanisms designed to aid tension resolution within the firm. Central to this process is a formal policy deployment and performance monitoring system, which will be referred to as the ‘performance management process’ (PMP). Broadly speaking, this system is aimed at directing and co-ordinating people’s decisions and behaviours, particularly innovative and budget-related behaviours, and ensuring that these are in line with overall corporate objectives. Specifically, the PMP performs three roles.

First and foremost, the PMP is about planning. The PMP is used to define organisational objectives and strategy based on a thorough and regular analysis of market trends, customer requirements, benchmarking data and business priorities. Establishing and maintaining firm-level objectives in this manner is, of course, not uncommon among business organisations. The frequency and ‘thoroughness’ of the process may vary, but the practice is widespread. However, an issue of increasing importance for large multinational organisations like Astoria is the dissemination of organisational objectives and strategy throughout the firm. The complexity and sheer scale of such organisations means that it is becoming imperative that participants have a clear understanding of organisational purpose, aims and objectives, in order that this understanding can be translated into more specific actions, initiatives and deliverables, which together constitute how organisational purpose becomes manifest. The basic rationale for imbuing managers with an understanding of the ‘bigger picture’ is that this understanding can, and is expected to inform day-to-day decision-making, including the resolution of tensions involving budgets and innovation. We provide some examples of the sorts of tensions that might arise at the interface between budgets and innovation shortly. For now, it is important to continue the description of the company’s management control package, as much of it was found to be geared towards securing the dissemination of organisational objectives in a manner which would enable tension resolution.

Within the PMP, deployment of organisational aims and objectives begins at the organisational level where senior managers are accountable for delivering results against the company’s ‘key performance indicators’. Astoria operated with a range of such indicators, but senior managers spoke of the need always to deliver against the ‘vital few’. Immediately, therefore, we see a degree of prioritisation, and this emphasis on the ‘vital few’ tended to inform the dissemination of organisational aims and objectives through the firm. In terms of the mechanics, dissemination proceeds through a process of individual alignment and by aid of a formal personal performance management plan. Basically, each individual in association with his or her manager is required to develop a personal performance management plan, which is intended to define his or her own contribution to corporate objectives. In doing this, PMP seeks to ensure that all organisational members are, in effect, accountable for business results, thus reinforcing the alignment of individual goals with corporate objectives. The process resembles ‘management-by-objective’, which has become a generally accepted model for managing organisational endeavour; for which the notion of ‘cascading’ is central. One manager commented on the importance of the cascading process as follows:

‘There’s the cascade from the top down, you know, right at the top. They’ll decide what the strategies are, and what the vital few are, the vital few objectives that we’re striving towards, and then as it gets cascaded down through the company clear accountability is assigned to each of those intents. So every single person has their personal management plan...and everybody will clearly understand their own personal objectives, their own roles and how it dovetails into their boss’s, and their boss’s, into the next one and up, up into the corporate goals.’

An important feature of the PMP is that it assigns managers the responsibility for identifying and managing the inter- and intra-organisational dependencies that arise from the dissemination of top-level aims and objectives through the firm. Managers are also empowered, through the PMP, to resolve unfolding issues and events, which may affect the achievement of organisational aims and objectives. Some of these issues, such as those relating to product launch deadlines, were observed to be grounded in the firm’s innovative practices. Some were also reported as having cost implications, which invokes consideration at this stage of Astoria’s budgetary system and how it relates to the firm’s broader management control framework and innovative processes.
5.2 Budgetary control, variance analysis and strategic priorities

The budgetary control process within Astoria is embedded within the performance management process. As part of strategy deployment, objectives relating to overall organisational goals are cascaded down through the company, with individual managers being held accountable for financial targets which are tied closely to these objectives. Financial performance is reviewed monthly with the ‘outlook’ for full year achievement assessed on a quarterly basis.

Operationally, therefore, Astoria’s budgetary process was observed broadly to reflect traditional budgetary practices, as depicted by Ansari’s (1979) six-step procedure. For example, both firm-level and business unit targets are established through a process of negotiation and consultation, and ongoing performance is measured against these targets by the accounting function. Variance reports are used to highlight deviations from targets and these reports are distributed to budgetees and their superiors on a regular basis. Importantly, however, variances of whatever magnitude are considered, not in isolation at the level of the individual responsibility centre, but in relation to the company’s current strategic priorities, and decisions are taken in the light of these considerations. This approach to variance analysis represents a departure from traditional budgetary practices as described in textbook literature. This literature emphasises ‘local’ variance analysis and implies variance correction at this level.

The procedures adopted at Astoria meant that budget variance correction does not necessarily over-ride other considerations. Rather, the budgetary system has to operate in association with an array of strategic issues, such as, for example, the possibility of forgiving budget variance correction if this is adjudged to support ‘the vital few’. Two examples may help to illustrate (1) the type of trade-off decision involving budgets and innovation that may occur on a day-to-day basis, and (2) how an understanding of the ‘bigger picture’ helps to inform these trade-off decisions.

First, understanding that meeting launch deadlines for new products was a strategic priority enabled managers to resolve issues relating to particular budget variances. Correction of variances would not necessarily be sought if to do so would jeopardise pre-arranged deadlines, and missing these deadlines was estimated to have a net negative financial impact on the company’s ability to meet overall contribution. The consequence of this was that managers could decide to reallocate resources between programmes funded by that budget, with products closest to launch taking priority. A second example concerns how unfolding market opportunities may lead to the reallocation of funds among responsibility centres. In response to an emerging gap in the market, the company launched a product which, while available elsewhere, had not been intended for the UK. The resulting cost implications of the UK launch had not been factored into managers’ budgets. The subsequent budget variances were treated strategically: budget variance analysis was based on managers’ understanding of the company’s strategic priorities, rather than the narrow aspect of short-term and localised budgetary control.

5.3 Continuing analysis of the ‘control package’

The above illustrates the role played by Astoria’s PMP in resolving tensions arising at the interface between budgets and innovation. However, other aspects of the company’s overall management control framework were observed to contribute to the management of strategic priorities and the achievement of firm-level goals. One concerns the issue of performance evaluation; in Astoria’s case, how the PMP system is used as a means of assessing progress towards organisational objectives. This is done through periodic reviews, which are held at both individual and management levels. Interestingly, though, evaluation was divorced from reward. All bonus payments are based on corporate results only. This is in keeping with the notion that managers should, where necessary, prioritise overall organisational objectives over individual-level targets. At the same time, Astoria’s approach to performance evaluation departs from received wisdom, which ties extrinsic motivators directly to the achievement of individual-level objectives. Analysis of this issue is beyond the scope of the present study, except to say that intrinsic motivation may play a bigger role in organisations than previously envisaged.

One prominent feature of the PMP framework is that the originally set targets are not changed during the twelve-month budgetary period. Consequently considerable attention is given to reviewing performance and progress towards set targets. While the frequency of reviews varies, with sales for example being reviewed daily, everyone is reviewed monthly, with particular emphasis at three monthly intervals. These are known as the ‘3+9’, ‘6+6’ and ‘9+3’ ‘outlooks’. At these points, reviews concentrate on understanding the ‘outlook’ as regards the likelihood of hitting set targets, as well as monitoring progress towards them. Interestingly, overall budgetary targets are deemed to be non-negotiable, which establishes further possible tensions between budgets and innovation. One manager explained the issue of overall budgetary targets as follows:

‘The target is the target. There’s only one target. That’s the one set at the beginning of the year, and that’s the one used for personal objectives. These points here (a reference to the 3+9, 6+6 and the 9+3) are not a realignment of the target: they’re just a management tool to understand how likely we are to still meet the target. And it’s an acknowledgement of the fact that ‘oh crikey, we’ve got a massive gap’. So then it’s ‘well, what management actions can we take to close the gap.’
The question of how to ‘close the gap’ invokes consideration of Astoria’s quality mechanisms. These quality mechanisms have a long history within the company and include such methods as the ‘Astoria improvement process’, ‘external benchmarking’ and ‘interactive and cooperative skills’. Each is expected to enable effective operation of the PMP, in that each is designed to promote a customer focus, while reinforcing behaviours necessary to secure business results. External benchmarking, for example, emphasises that, in addition to existing practices, it is also the responsibility of each individual organisational member to seek-out, understand and communicate information about the ever changing business environment, competition and customer needs. The sharing of such knowledge through structured communication processes is envisaged to enable rapid reactions to changing circumstances and encourages all employees to look beyond their own environment for business solutions and better ways to work. Related to this, the Astoria improvement process represents the formally designated means of problem-solving and ‘root cause analysis’, while ‘interactive and cooperative skills’ represents a set of guidelines for identifying and nurturing behaviours and ‘people skills’ that help to strengthen the focus on customers and business results.

There is undoubtedly an overlap of focus and mutual reinforcement of purpose among the controls comprising Astoria’s control package. The quality mechanisms support the objectives of the PMP, and vice versa. But, this was deliberate. According to those interviewed, the company’s broad based control framework is used to emphasise the view that control should be seen as a holistic process which recognises that dynamic interaction between organisational parts is imperative to maintaining organisational success. It has also been developed to emphasise the company’s core values of quality and innovation, both of which are seen as key drivers of customer satisfaction and ultimately business success.

Moreover, while PMP is undeniably a top-down process, it does also include scope for both ‘bottom-up’ contribution and encourages horizontal collaboration. Its focus on disseminating company purpose, aims and objectives through the firm both informs and facilitates managers’ use of PMP and the quality mechanisms as aids to resolving the tensions that inevitably arise between budgeting and innovation. Managers described PMP and its accompanying quality mechanisms as offering a ‘universal’ approach to problem solving. The formal use of these control mechanisms is expected to ensure that the mediation of accountabilities governing situations of team working (for innovative purposes) remains focused towards achieving organisational objectives. This is illustrated in the following remark:

‘It might be that you just don’t know that person, and they’re distanced from you functionally. In which case it’s more important to formalise, and especially if there is someone that is, has an ulterior motive to holding on to things or whatever. Then the really neat trick that we use in Astoria, to resolve all particular points of issue, is using our quality process, whereby you can call a meeting, have an objective, have proposed solutions. You work them together. You know you can neatly use (the quality process) for talking to people and formalising things and, you know, detaching yourself from the personality side of things and can say like: this is the issue, these are some proposed solutions. And then, you know if there is an issue then you can escalate it or whatever, but you do it professionally.’

5.4 Attitudes towards innovation in the context of budgetary control

Managers’ repeated reference to organisational objectives in response to questions about innovation, budgets, and the role of Astoria’s management controls in securing both these organisational imperatives simultaneously, reveals an important dimension concerning the interplay between budgets and innovation. This dimension may be described as managerial attitudes. Extant literature on the subject of budgeting presupposes that budgets deter innovation. Budget responsible managers are reluctant to take risks for fear of exceeding the budget and thereby receiving a negative performance evaluation. This suggests that managers would tend to hold attitudes towards the budgeting-innovation interplay which (1) favour budgetary targets in trade-off situations, and (2) generally reveal a feeling of ‘being constrained’ by the budget. Neither attitude, however, was evident at Astoria. This may be illustrated through considering how issues of trade-off were dealt with.

As already alluded to, a frequent source of tension was the extent to which activities and projects required modification and development in order to respond to unfolding circumstances, and the impact this had on budgets. Such modifications usually required the consumption of additional resources, but this entailed potentially negative implications for individual managers’ budget targets. In seeking to resolve the tensions between these competing objectives managers generally used the PMP process and the quality mechanisms both to focus on the ‘bigger picture’, and to ‘de-personalise’ the problem in order to secure co-operative behaviour and effective communication. As one manager explained in relation to this:

‘In the process of negotiations, yes, I think implicitly they (the quality mechanisms) are used because we have to have a clear problem understanding, problem definition in order to be able to have a feasible discussion and a focussed discussion. Because the last thing you want is a sort of uncontrolled fight between one blaming the other, and saying you don’t do as much as you should do. But then ultimately if you have the facts on the table, and I think Astoria has some very strong tools in order to do that, then with the facts you should be able to reach a decision.’
Another manager emphasised the ways in which the process could be used to diffuse tensions arising at the interface between budgets and innovation that affect individual managers’ performance. Commenting on issue resolution she said:

‘So you don’t say ‘look, you idiot, you know, you don’t know what you’re talking about’. You can take them back to quality principles and say, OK, maybe we have a misunderstanding on the root cause of the problem and you go back to the basic steps. So the time when you overtly use the steps is when there’s an issue and you use it to de-personalise something, or smooth through the fact that you have got a complete idiot who doesn’t know what they’re doing ... You can overtly use the quality process to come to at least an acknowledgement that there is a difference of opinion.’

Managers’ utilisation of Astoria’s PMP to resolve tensions and explore possible trade-offs provides insight into how formal management control systems may be designed and used to avoid the problem of ‘goal displacement’. This frequently occurs where budget responsibilities encourage managers to focus on achieving individual-level targets to the potential detriment of organisational objectives.

Many responsible budget managers are likely to be ‘the primary initiators of entrepreneurial activity’ (Bartlett and Ghoshal, 1993). Potentially, therefore, it is these managers who may feel most constrained and restricted by budgets and cost control. In order to gain insight into this issue, managers were asked, initially, what the term innovation meant to their role. As might be expected, responses were varied, from ‘pure’ innovation with long-term implications to ‘fixing difficult problems’. As one manager remarked:

‘Every programme’s got its own set of problems and getting people together as a team to brainstorm solutions and go off and evaluate and deliver and all the rest of it. That’s innovation as well.’

Generally, managers perceived innovation as ‘doing something new’ or ‘doing something better’. Managers also commented how the company’s process-driven approach facilitated responsiveness and flexibility, which were viewed as key drivers of innovation. References to ‘better’ and ‘flexibility’ may stretch the definition of innovation, but it is important to note that interviewees reported being involved in the search for and/or the application of new and different approaches to meeting organisational objectives. Given this, it was interesting to find that, in contrast to received wisdom, managers did not feel constrained innovatively by their budget responsibilities. To the extent that financial matters impinged upon the pursuit of ‘innovation’, it tended to be explained in terms of there sometimes being insufficient resources to ‘sort things out’, including addressing project development issues (which can involve further innovations), rather than accountability for budgetary performance restricting people’s desire to engage in innovative ventures and process improvements. When asked, in the context of a direct discussion on innovation, ‘Do you feel constrained in any way?’, not one respondent made reference to the budget. Most replied that they did not feel constrained, and of those who did mention potential constraining factors, these tended to relate to empowerment and staffing issues. One manager remarked that he felt ‘constrained in some ways by not having enough hours in the day.’ The need to feel empowered appears key to unleashing innovative behaviour. Holding budget responsibility appeared to have little constraining effect. This brings into question arguments presented as part of the Beyond Budgeting debate.

5.5 Managing partial controllability

Further insight into how budgets may not be as constraining as is generally believed concerns the attitude held by Astoria’s managers towards the issue of partial controllability.

The complex nature of Astoria’s business requires the organisation to accept the need for interdependency and the resulting ‘fragmentation’ this causes. The existence of these interdependencies is ‘hugely intentional’, to quote one interviewee. One way in which interdependencies manifested concerned the extent to which managers had more than one ‘stakeholder’. One manager, for example, commented that ‘it is such a big company, and we are so diverse that everybody seems to have two or three bosses now’. Another manager commented:

‘I guess there are some places where there isn’t interdependency, but I can’t think of any. Everywhere I’ve worked in this organisation requires a lot of people to pull for you. If you don’t work with other functions you’re going to end up with gaps.’
Interdependency is necessary not only as a consequence of current operating conditions but also as a means of facilitating the collaboration and knowledge sharing which is deemed essential for innovation and learning to occur. Such a strategy, however, inevitably leads both to the existence of shared responsibilities and limits the capacity to define individually autonomous centres of responsibility. Managers incurring these joint responsibilities therefore experience only partial controllability in the discharging of their (budget) accountabilities. In essence, partial controllability is a consequence, not of innovation directly, but of the arrangements and management practices that are necessary for promoting and facilitating innovation and learning.

Controllability is traditionally seen as a potential constraint on innovation, as it may deter managers from working outside their designated areas of formal responsibility for fear of eroding the degree of control they might be able to exert over required outcomes (Hopwood, 1972). In the light of this, partial controllability would be expected to be seen as problematic in terms of innovation and learning, but the study found little evidence to suggest that managers were deterred from engaging in innovation because of a lack of controllability.

In order to address the situation of partial controllability managers at Astoria are required to 'negotiate' joint accountabilities where shared responsibilities occur. The majority of those interviewed argued that in fact relatively few, if any, of their accountabilities could truly be regarded as individual. It was therefore assumed to be the job of the individual manager to determine where influence over others was required and to negotiate how it should be exerted. This, according to interviewees, requires communication and cooperation beyond the formally defined, hierarchically arranged, line responsibilities associated with budget responsibilities. Interestingly, however, rather than perceiving this as problematic, the study suggests that partial controllability is seen as a challenge: a fact of organisational life which may actually increase rather than decrease managerial cooperation. Managers felt that it was integral to their role to find a way of influencing the behaviour of others so as to enable achievement of their own individual targets, and regarded this as part of the challenge of managing the tension between budgets and innovation.
6. Summary and conclusions

Budgets and innovation have long been viewed as antithetical, but an increasing globalised economy demands that organisations achieve both simultaneously. The present study has sought to gain insight into how the inherent tensions between budgets and innovation may be managed within a framework of management control. The aim was to contribute a body of knowledge to an issue of increasing importance.

The study’s findings point to less of a problem than has thus far been portrayed in both the practitioner and academic literatures. The reason for this is largely grounded in the company’s management control system. Astoria was observed to operate a broad framework of control, with several specific processes being both designed and used by managers to resolve various day-to-day tensions, including those relating to the interplay between budgets and innovation. The role of management control systems in tension resolution is a neglected research topic at present, but it seems that some of the changes to both the scope and practice of management control may be driven by this very issue. Simons (1995) has alluded to this possibility, while the present research has outlined some of the more specific (perhaps organisation-specific) control systems which may be involved.

The broadening of the management control framework observed in this study holds implications for the long-held view in accounting literature, practitioner and academic alike, that budgeting lies at the heart of any organisationally based model of control. Budgeting may no longer be central. This in itself may help to explain why managers may not perceive the interplay between budgets and innovation to be particularly problematic. Moreover, furnishing managers with a range of management controls which they may call upon for tension resolution purposes may reduce the pressure on organisations to change the design and operation of their budgetary systems. The ‘Beyond Budgeting Round Table’ maintains that ‘trust and the resulting empowerment – where staff are free to exercise discretion – are not possible with budgets still in place, because the entire system perpetuates central command and control’ (CIMA, Better Budgeting, 2004). This may prove to be the case in situations where the budget operates as the organisational control mechanism. However, findings here suggest that, rather than rushing to dismantle the budget, the interplay between budgeting and innovation may be managed by incorporating budgeting within a wider control framework, one which provides managers with the tools to manage tensions and resolve potential conflicts.

Perhaps the area of budgeting where changes would be most welcome concerns the design and operation of budget variance analysis. Budgets are based on the cybernetic paradigm, which emphasises negative feedback and variance correction as the basis of effective control. However, notions of negative feedback and variance correction fit awkwardly with the general uncertainty that characterises innovation and learning. A particular issue for managers at the case study company as they sought to respond innovatively to unfolding events and new information, was the question as to whether or not to correct a budget variance, given these new circumstances. The way this issue was dealt with – through discussion and negotiation and by reference to company strategy – epitomises how budgets may be approached in a manner which enables budgeting and innovation to dovetail, rather than conflict. However, this represented a procedural or process resolution to the issue. It did not involve changes to the way budget variances were calculated (at the responsibility centre level) or the information distributed. Systems designers may wish to consider how best to approach the question of budget variance analysis from a design or structural perspective as part of any attempt to establish an appropriate means of budgeting for the contemporary organisation.

Calls for the demise of budgets are grounded in the belief that budgets deter or constrain innovation, but this study found little evidence to support this long-standing presumption in accounting literature. The availability of formal processes to assist tension resolution may account for these results. This situation may also explain the positive (or at least non-negative) attitude that managers showed towards both their budgetary targets and their lack of controllability. Consequently, it is plausible to argue that the question of how to secure cost control in contemporary organisational settings which demand responsiveness and innovation, need not preclude references to a mostly traditional budgetary system. Better budgeting need not mean beyond budgeting.
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