The Influence of the Linkage Between Strategy and Budgeting of Implementing Strategic Decisions

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Abstract

There is widespread agreement among management researchers that company strategies are of little importance if they are not effectively implemented to produce intended results. For this to happen strategies need to be consistent with operational plans. The budget is one of the more important of these operational plans. The budget is the tool through which resources are allocated to planned activities. If the budget is to be useful in implementing strategy, it should be prepared after company strategy has been specified. This way, resource allocation will support the strategy being implemented and will enhance successful implementation of strategy. In this, we rest the proposition that strategy implementation will be more successful in companies where strategies are first specified before budgets are developed.

A survey was conducted among large private manufacturing companies in Kenya. Seventy three companies participated in the survey. A questionnaire was developed and administered on top managers of all the 73 companies. The data obtained was analysed using the nonparametric Mann-whittney U test. This test was preferred since the data collected was largely ordinal.

The results showed that companies where strategies were first specified before budgets were developed were more successful in implementing strategies than those where such linkage was not maintained. These findings were consistent with the theoretical position as well as existing empirical evidence.

Introduction

There is widespread agreement among management researchers that company strategies are of little value if they are not effectively implemented to produce intended results (Pearce and Robinson, 1988). However, although effective implementation of strategy is so important, it is not easy. Many well formulated and appropriate strategies fail when attempts to implement them are made. Problems do arise when attempts are made to implement strategy (Bonoma, 1984; Alexander, 1985;Hussey, 1988). Some of these can be addressed so that implementation is successful. Thus a good strategy can be salvaged if implementation problems are promptly addressed. The strategy can fail where either such action is not taken promptly or it is not possible to take the remedial action.

One of the major reasons given for such failure is that there is an inconsistency between strategies and operating plans (Ringbakk 1971; Steiner, 1979; Steiner, 1983;

Cornfield, 1984; Gray, 1986; Pearce and Robinson, 1988; Thompson, 1990; Tregoe and Tobia, 1991). A strategy is an umbrella of several activities. In order to implement the strategy, it has to be broken down into these activities which are then sequenced for action. Operational planning is the process by which this is done. The resultant operational plans are the basis for implementing strategy. If the strategy being implemented is inconsistent with the operational plans intended to implement it, we are either implementing a different strategy unknowingly or we do not understand the action requirements of the current strategy. It will not be surprising that the implementation efforts fail.

The budget is one of the more important of these operational plans. The budget is the vehicle through which resources are allocated to various company activities. Budgetary allocations represent management commitment of plans to actions. The activities, projects or programmes provided for in the budget should derive from the grand strategy of the company (Steiner, 1983; Pearce and Robinson, 1988; Tregoe and Tobia, 1991). Only then can the activities financed reflect the strategic thrust of the company. Thus, the theoretical position is that linking a company's strategy to the budget enhances effective implementation of the strategy.

This article reports findings of a study carried out within large, private manufacturing companies in Kenya. The study examined aspects of strategy development and implementation within the companies studied. We evaluated the hypothesis that linking a company's strategy to the budget will enhance effective implementation of strategy.

Literature Review

The interface between strategy and budgets is important for it profoundly influences the implementation of strategy. It is imperative that budgets, other operational plans and strategy are integrated if the latter is to be effectively implemented. Stonich (1975) posits that all management systems must be interrelated with planning systems if organizational success is to be achieved. The planning systems set the guidelines and direction for organizational action. The other management systems then contribute to the execution of the tasks specified by the planning system. Similarly Steiner (1979) points out that strategic planning is inextricably interwoven with the entire process of management. This view is also shared with Hussey (1971), Hobbs and Heany (1977), Henry (1977), Piercy and Meirion (1984), MacMillan (1986), Gray (1986), Thompson (1990) and Tegoe and Tobia (1991). It is unrealistic to separate strategy and other plans in the company. Through these other plans, strategy implementation is possible. If strategy is not integrated with other company management systems, the value will be greatly reduced.

The interrelated nature of strategy and other company management systems can also be highlighted by examining some reasons that have been advanced to explain why planning fails in companies. Various writers, notably Ringbakk (1971), Steiner (1979) and Mieseing (1984) have addressed this issue i.e. why planning fails. They collectively argue that planning or strategy will fail if it is not properly integrated with other management systems in the company.

The type of integration between strategies and budgets needs further clarification. Banks and Wheelwright (1979) suggested that it was dangerous to develop operating budgets before the long term plan is finalized. In this, they implied that the plan should be developed first followed by the corresponding budget. This view is further amplified by Nagel (1984) who argues that it is a mistake to start allocating resources before strategy formulation has been carried out. Similarly, strategy formulation and resource allocation should not go on simultaneously. Day (1984) also posits that a strategy describes the direction a company will take and guides the allocation of resources. Strategy can only guide resource allocation if it is first specified after which resource allocation can be done. This view had earlier been taken by De Noya (1978) when he argued that the first year of strategic plan should be the annual budget. In such a system, the strategic plan always loses one year to the budget and a new year is added to the plan.

During strategy development, various analyses (external and internal) are carried out and key (strategic) issues are identified . Resource allocation is then done based upon those issues (Steiner, 1983). This means budgets (resource allocation mechanism) would be developed after strategies have been formulated. This view is similarly taken by Halachmi and Boydston (1991) who suggested that the strategic planning cycle should precede the budget cycle in an organization. Budgeting will be more useful to an organization if it is done after the strategic issues have been identified and specified. In this way, resource allocation will support the strategic thrust of the organization.

All these ideas suggest that companies should first formulate strategies before developing budgets. The budgets serve to allocate resources according to the priorities identified in company strategy. Such a timing linkage enhances success full strategy implementation. We empirically tested this proposition using data from Kenyan companies.

H: Companies that link their strategic planning cycle to the budgetary cycle (i.e. maintain a strategy-then-budget sequence) will be more successful in implementing strategy than those in which such a link is not maintained.

Methodology

Questionnaire Construction

In order to test the hypothesis formulated for this study, it was necessary to collection standard data from a large number of respondents. We opted to conduct a a survey to collect this data. A questionnaire was required for the survey to be carried out. The questionnaire that was constructed had both open-ended and closed questions. Closed questions generated standard data that could be used for comparisons across respondents. The open-ended ones were meant to tap in-depth, additional qualitative data which would be used in interpreting the findings of the study.

We generated questions from three basic sources: previous empirical studies, theory and the researcher's experience. The questionnaire was revived several times before it was ready for use. Several panel discussions were held and the questionnaire was revised after each round of discussions. The questionnaire was then tested, refined before it was ready for use.

Sampling and Data Collection

The population for this study comprised all large, private manufacturing companies operating in Kenya. We developed a sampling frame which had 548 companies. All these companies were contacted. In doing this, we contacted more companies than e intended to interview. This was in anticipation of possible non-cooperation from some of the companies.

Data was collected through personal interviewing. Respondents to the study were either Chief Executive Officers, their deputies or department heads. We felt it was these top managers who were most familiar with and involved in the strategy processes in their companies. Where possible, interviews were tape recorded.

The interview for each company was conducted in two stages. First respondents were asked open questions about their companies. The researcher used probes to bring out more information and to clarify issues raised. In the second stage, respondents filled questionnaires in the presence of the researcher. These provided standard numeric data. In both interview stages, similar issues were raised. This helped check for consistency in the responses. Interviewing was done between July and November 1990. A total of 73 companies fully completed the interviews while 11 of them partially participated. For subsequent analysis, the latter were eliminated and 73 companies were retained. These companies were drawn from various industries (Table 1).

Table 1: Classification of companies by industry

	n	%
Chemicals, Petroleum, Rubber and plastic products	21	29%
Fabricated Metal Products, Machinery and Equipment	15	20%
Food, Beverages and Tobacco	14	19%
Textile, Weaning Apparel and Leather Industries	10	14%
Paper Products, Printing and Publishing	6	8%
Wood and Wood Products	3	4%
Non-Metallic Mineral Products	2	3%
Other Manufacturing Industries	2	3%
TOTAL	73	100%

Research Variables

Success in strategy implementation. Respondents were asked to evaluate a strategic decision which had recently been implemented in their company. A success score was obtained based on three evaluation questions ranked on 5-point scales. The score was a sum of these questions. This method is very similar to that used by Alexander (1985).

Strategy - budget sequence. This is an indication of the relationship between strategies and budgets. We sought to establish whether strategies preceded budgets or some other sequence was in place.

Data Analysis and Results

The analysis in this study required that comparisons be made between groups of companies. We used the non parametric Mann-Whittney U test for detecting significant differences. This test was preferred over the parametric t-test since the data collected was essentially ordinal.

The Mann-Whittney test checks how many times the scores of one group are greater or lower than the other group. If there is no significant different between the groups, no one group will register consistently higher or lower scores. In our case here, the companies that maintained the strategy-budget linkage were more than those which did not maintain such linkage (Table 2). Companies that maintained the strategy-budget linkage registered consistently higher success scores that those that did not maintain the linkage. The difference was statistically significant (prob-value, p=0.000).

Table 2: Linkage between strategy and budgets

	n	%
Strategy-Budget linkage	39	53%
No Strategy-Budget Linkage	34	47%

Prob-Value for M-W test of significance: p=0.000

39 of the companies (53%) reported they first developed strategies followed by budgets. These companies that maintained a strategy-budget sequence (i.e. strategy preceded the budget) were significantly more success in implementing strategy than those not maintaining such a sequence. The prob-value for the Mann-Whittney test of significance was 0.000. This shows that the difference in success between the two groups of companies was highly statistically significant. This results support the hypothesis that was tested in this study.

Discussion

We pointed out earlier that there is a widespread consensus among management researchers and practitioners that linkage strategies to budgets enhances successful implementation of strategies. The results of this Kenyan study are consistent with this position. In developing strategy, managers conduct strategic analyses which assist them to identify the key issues facing a company. Those issues define the strategic agenda for the company. If the company has to be successful, resource should be allocated taking into account the strategic thrust of that company. Strategy provides the guideline regarding how company resources should be allocated for maximum corporate benefit. This is why strategy should come first followed by the budget. Bryson (1995) supports this position that budgeting is more useful to a company if it follows strategy formulation.

The position had been amplified earlier by Banks and Wheelwright (1979). They pointed out it was dangerous to develop the operating budget before the long term plan was finalized. If the long term plan is made parallel to the operating budget, it will be difficult for managers to relate their performance to strategic objectives. This view is supported by other researchers including Steiner (1983), De Noya (1979) and Meirion (1984) and Day (1984).

All organizations are environment serving (Ansoff, 1984; Ansoff and Sullivan, 1993). They depend on the external environment for their survival. They have to understand requirements of this environment and adapt to them. Failure to do this will give rise to a serious strategic problem characterized by the maladjustment of the organization's output and the demands of the external environment. If the organization has to remain successful, its strategy has to address environmental challenges adequately. Enough resources have to be made available to ensure the strategy is aggressively implemented. The greater the environmental challenges, the more aggressive the strategy should be and the more resources will be required Adequate response to environmental challenges thus requires that managers define their response to the challenges and then allocate resources to carry out the strategy. If they started by setting the budget, it is not clear how this will lead to adequate response to the environment. Perhaps this would lead to success only if the environment was stable (Ansoff and Sullivan, 1993).

Managers who participated in the study underscored the importance of good planning as a guide to developing budgets. The General Manager of a local pharmaceuticals company pointed out that:

"You've got to plan to come up with a sensible budget. When you plan you have to look at your weaknesses, strengths and competition. Planning is essential these days. You cannot run a business without a plan."

Similarly the Chief Executive Officer of a subsidiary of a British company said thus:

"We have to plan all our activities. Our current operations are tied up to the annual plans. Annual plans are linked to the long term plan. The annual plan is the budget."

The Managing Director of an American company also explained that their strategic plan was developed before functional plans and budgets were built.

"Overall, we would have a mission statement of where the company would want to be over the next five years. That would be fairly specific. This is at a corporate level. It then becomes part of the divisional level. We would then do a strategic plan that would cover a period of five years. This is debatable because in some countries, five years is too long. Here, we look at five years. Into the strategic plan, we built a functional plan to that. We actually look down and say: If we have to get to those five years, how do we actually built this up by product? What is it going to required by resources? What needs to happen?."

Limitations

While the results of this study provide useful insight regarding strategy implementation, it is important to keep in mind limitations of the study. First, there are factors other than the strategy-budget linkage that influence strategy implementation. These other factors were not controlled in this study. Hence one cannot draw conclusions about causality here. Similarly, industry effects were not controlled in the survey. Rather than sample companies from one industry, we sampled across industries.

Third, respondents chose the strategic decisions on which they based their evaluation of success. There were differences in the type of decisions selected. Some may have been more complex and therefore more challenging to implement than others. Such variations were not controlled in this study.

Finally, the evaluation of success was based on self reporting by the respondents. The accuracy of the success evaluations thus depend on the accuracy of the self reports by the respondents.

Conclusions

The results obtained here support the view that linkage strategy to budgets enhances successful implementation of the strategy. Strategy dictates what is supposed to be done in the company if continued success has to be achieved. Resources should be allocated on this basis. Any other resource allocation criteria (if used) are likely to lead to sub-optimal results. If a company has adopted a formal strategic planning system, it is important that the strategic planning cycle comes before the budgetary cycle. This way, strategy will guide resource allocation in that company. There are other factors that do influence effective strategy implementation. They can lead to success or failure in a company's implementation efforts. We are emphasizing here that maintaining the correct timing between strategy and the budget is also a very important factor in strategy implementation.

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