

Managing with budgets

(Editor's note: This is the third and final in a series of articles by Organizational Systems Inc., a research-based consulting firm specializing in solving organization and management problems. The first two articles are found in the October and November, 1979 issues of GOLF BUSINESS, respectively.)

In the first two articles of this series we dealt with two questions: (1) what are budgets?, and (2) how is a budget formulated? The second question was answered in two ways. One was the actual method of formulating a budget in accounting terms, the second was the wider process of budgeting, or how different actors in the organization play different roles, and thereby influence the outcomes of the budgeting process.

It is unwise, however, to think that once we go through the budgeting process everything will take care of itself. What happens with the budgets during the budget period is equally important. Different organizations use budgets for different purposes; and the uses a budget is put to will affect not only the budgeting process in the next period but also a host of other factors.

In this article, which is the last of the series, we shall look at these uses and their implications. There are six possible uses of a budget. An organization may use the budget in one, two or all of these ways, and other organizations may forget altogether that a budget exists. The six possible uses of a budget are: (1) as a tool for control; (2) as a form of progress report on work; (3) as a standard for performance evaluation; (4) as a tool for motivating managers; (5) as a means of feedback on the changes occurring in the environment; and (6) as a source of information for future planning.

Each of the uses offers a different perspective. At the same time they are not independent of each other. How you use a budget for control will certainly affect the motivation of managers. We find, therefore, that a logic emerges as to when a particular use is feasible and when it is not. This logic is not the same for all organizations. Some parts of it will hold true for some organizations, while other

parts may be valid for others. It is up to the superintendent to construct his own logic, and thereby derive the strategy for managing with budgets.

Every superintendent has his own notion of what control means.

1. Budget as a tool for control

Every superintendent has his own notion of what control means. The diversity of such notions becomes manifest in the way budgets are used for the purpose of control. The original notion of budgetary control related merely to the financial control of organizational activities. The main purpose here was to ensure that the limits on expenditure were observed by individual departmental managers. This notion can still be observed in operation in the more bureaucratic organizations. Normally it is accompanied by the use of a fixed budget.

Once the budget is set, the controller is to see that the budgeted amount is spent.

Once the budget is set, the only responsibility of the controller is to see that the budgeted amount is spent. In the extreme cases, underspending is considered to be as bad as overspending or even worse.

The second prevalent notion about budgetary control is to keep a check on the employee's activities. This type of control is exercised in two ways. First is to control the extent of resources allocated to certain activities. This method is effective under the circumstances where authorities are clearly defined and the fixed form of budget is used. The authority of the subordinate manager is strictly restricted as regards

transfer of funds sanctioned for one activity to another activity. This restriction becomes meaningless if a variable budget is used without sophisticated controls, because the subordinate manager can always petition for changes in the budget. The two conditions of restrictions on authority and use of fixed budgets therefore must exist simultaneously. The second way of exercising this type of control is through financial information. This requires an extensive information system, and inadvertently leads to voluminous paper work because every item of expenditure must be carefully explained by the subordinate manager.

Some organizations establish guidelines for the managers with a view to utilizing budgets for one or the other forms of control. However, once established, the actual control is forgotten. If a superintendent regularly files his reports, the upper level management is satisfied simply with the regularity of reports and ignores the actual activity of comparing the reports with the original budget. Invariably, the comparison is left until after the budget period is over, and by that time superintendents invent a score of ways to justify the departures from the original budgets. These justifications may or may not be supported by the levels of performance achieved in terms of production or dealing with whatever emergencies arose during the budget period.

The ultimate effectiveness of the budget as a tool for control is therefore not dependent only on the fact that you have it, but also on how you use it. If not used properly it becomes blunt like any other tool that has been lying around in the stores.

2. A form of progress report

This is a variation on the theme of control. When the controller or manager is far removed from the department either physically or in terms of understanding the technology, more often than not the budgetary information is used to gauge the progress of work going on in that department. Although this is a fairly common phenomenon encountered in research organizations, clubs perhaps will not face this situation.

For one reason, club management is never so far removed physically from the operations, and the second reason is that although the general manager may not exactly know the intricacies of every operation, the progress of each department can be determined through a visual inspection.

3. Performance evaluation

Apart from control of employee ac-

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tivities, there has always been a controversy about the methods to be used for evaluating managerial performance. A superintendent is expected to plan, coordinate, organize and control the activities of his subordinates. Whenever questions about evaluating his performance arise, several issues need to be dealt with.

The first issue is how to quantify performance. The budget presents itself as the most obvious answer. It is argued that the budget itself is a quantification of goals and the results

Improper implementation of the budgeting process will allow slack to be introduced.

of his performance can be translated in financial terms and compared with the budget as the standard.

This argument is valid only if the underlying assumptions have been met. These assumptions are first that all the goals can be quantified in financial terms, and second that all other factors have been under the superintendent's control.

Both the assumptions can be challenged very easily. If the golf course maintenance budget is set at x dollars, it still cannot capture the essence of the quality of the golf course. In such a case, the superintendent's performance, which is essentially reflected in the quality of the golf course, cannot be judged on the basis of whether he kept within the budget limits.

The second assumption can again be challenged because it is a rare situation when all the factors are under the superintendent's control. There is always the weather, breakdowns of equipment, non-availability of skilled people, and a host of other factors that can cause hard, concrete problems for the superintendent.

The second issue is whether we are trying to evaluate the superintendent's compliance with the budget or his ability to innovate and use discretion. If the budget is used as a standard for performance, we may be fallaciously seeking to evaluate the superintendent's compliance. In this case, it may be a case of punishing initiative. If a balance is to be struck between the two aspects of his job, then the budget cannot be used as a standard but rather should be used as a guideline.

The third issue is the adequacy of funding as put down in the budget. If the budgeting process is used as a means of striking compromises, the adequacy of funding is always questionable. In such instances, compliance with the budget could at best reflect partial achievement of goals whether they be the organization's goals or the superintendent's goals.

The fourth issue is that of the presence of slack in the budget. Slack is defined as the understatement of revenues or overstatement of costs. Superintendents introduce slack in the budgets mainly for the reason that the three above mentioned issues have not been resolved in the organization. The use of budgets as a standard for performance evaluation without a resolution of the three issues creates an anxiety amongst superintendents. As a result, they introduce slack in their budgets. Slack will help a superintendent come out a winner no matter what happens. For example, if revenues have been un-

derstated then under normal or favorable conditions the actual revenues will always exceed the budgeted revenues. Under adverse conditions the revenues will match the budgeted revenues. Similarly an overstatement of costs will always place the superintendent in a situation where his actual costs are either lower than or equal to the budgeted costs.

The phenomenon of slack is entirely related to the match between the budgeting process and the performance evaluation. Improper imple-

Quite a few superintendents strive for a zero variance . . .

mentation of the budgeting process will allow slack to be introduced, and then performance evaluation becomes meaningless. On the other hand, improper performance evaluation will create a motivation for the introduction of slack. Many organizations get caught up in this vicious circle.

4. A tool for motivating

The budgeting process gives rise to three outcomes—organization of work, establishment of goals and clarity of influence patterns. The budget then means more than just an

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allocation of money. Superintendents know exactly what the board and club members want and will be looking for. Superintendents also know exactly what activities are to be performed to provide the members with what they want. As a consequence, criteria for performance get clarified. The super-

intendent is not in a dilemma as to whether he should strive to achieve the stated goals of the club or whether to go for the hidden goals of the most

A budget prevents wasting energy on diverse political activities.

influential members.

This has two implications for the superintendent. First, the superintendent is no more anxious about this dilemma and he can use all his energies for the purpose of accomplishing what he is expected to achieve. Second, the superintendent has no more reason to try and play up to individual members of the board or the budget committee in order to maintain support for his position.

Such a budget not only directs the energies of the superintendent towards what is to be done, but also prevents wasting energy on diverse political activities. It may sound as if the superintendent is being manipulated through budgets, but this is not the case. It allows the superintendent to use his competence for his performance and growth. This is what management is all about.

5. Feedback on changes

The budget can serve as a very useful means of feedback on the causes of variation between planned performance and actual performance. A number of techniques have been developed in the field of managerial accounting for the analysis of performance. We shall illustrate one technique with an example.

Any operation will at least involve two factors—materials and labor. The cost of each one may be affected by either the quantity (units of materials or hours of labor) or the rate (price per unit or wage rate). Estimates of quantity and rate are used in the preparation of budgets. During the budget period, however, the actual usage of quantities and actual rates will vary from the estimates. These variations will create differences between actual and planned performance. Analysis of these differences will give us information on the causes of variance.

Let us say that for a particular material the following quantities and rates were estimated and actually used.

TABLE 1.

| Material X | Actual | Budgeted |
|---------------------------|----------|----------|
| Quantity required (units) | \$ 2,000 | \$ 1,800 |
| Rate (price/unit) | \$ 7.50 | \$ 8 |
| Direct material cost | \$15,000 | \$14,400 |

We find that the actual expenditure exceeded the budgeted amount by \$600. Both quantity and price fluctuations have caused this difference. The extent of the effect of each quantity and price can now be calculated. The effect of quantity is called the usage variance, and the effect of price is called the rate variance.

Usage variance is calculated by the following formula: Budgeted Quantity (1800) - Actual Quantity (2000) X Budgeted Rate (9) = Usage Variance (-1600). The negative sign indicates that the usage variance is un-

favorable and has led to increase in the overall expenditure.

The rate variance is computed using the following formula: Budgeted Price (8) - Actual Price (7.50) X Actual Quantity (2000) = Rate Variance (+1000). The positive sign indicates that rate variance is favorable and had the effect of reducing the overall expenditure.

The overall difference between budgeted and actual expenditure is the sum of the usage variance and the rate variance. In this case: (-1600) +

Unskilled personnel are cheaper but need more hours.

(1000) = -600.

This is only one of the techniques of computing the effects of different factors on the differences between budgeted and actual expenditures. Depending on which factors caused the difference, we can start exploring what changes in the organization or the environment are going on.

For example, usage variance due to labor may be caused by unavailability of skilled personnel. Unskilled personnel are cheaper to get, but they need to put in more hours for the same job. An imbalance between the effects of skills and wage rate can be understood through such analysis. Questions may then be raised as to why skilled personnel are not available. It is possible that other organizations are luring away skilled personnel by offering higher wages. On the other hand, unfavorable wage rate variance may indicate that the club is paying out higher wages to the people with low skill levels.

Quite a few superintendents strive for a zero variance between their budgets and actual performance. This is due to the fact that variances are used for evaluation purposes. Some superintendents resort to the use of slack to keep within their budgets. Top management needs to look into those departmental budgets where variances are either zero or always favorable. They will most likely find the existence of slack.

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Here again we find that the information obtained through such analysis can be used for control as well as performance evaluation. A restricted use of this information for

A budget can serve as a source for future planning.

control and evaluation would be ineffective if the causes of variance lie outside the control of the manager concerned. The use of budget as a means of feedback provides an avenue for the top management to see what is going on around them.

6. Information for future planning

A budget can serve as a source of information for future planning when all the other uses of a budget are properly matched with one another. The use of budgets for control and evaluation must be coupled with the use for feedback on environment. Together these three will motivate the managers towards performance and valid record-keeping. The information generated out of record-keeping and other analyses can then be used for future planning. Since future planning occurs through the budgeting process, we go back to the actual implementation of the budgeting process.

Summary

Budgets are used in different organizations for different purposes. In most cases we find only partial utilization of budgets even for the two or three purposes they are used towards. It is not our intention to prove any incompetence on the part of the practicing superintendent. The day-to-day activities sometimes force the superintendents to skip a few steps. This almost inevitably leads to skipping a few more steps. Unwittingly the organization relinquishes proper use of a management process which is an integral part of any economic organization.

In this series of three articles we have tried to focus on the complete meaning of budgets and budgeting. Fertilizers, seeds and water are necessary to grow a quality turf. It is not enough, however, to just throw these on the ground. The sequence and amounts in which each one is applied determines the quality of turf and the

play. Similarly budgets are necessary and vital to any organization, but the way they get formulated and way they are used determines how they will affect the functioning of the organization.

Each topic that has been discussed in these articles is related to every other topic. All the topics together are related to other things that go on in the organization. These articles give you only a glimpse of the total organiza-

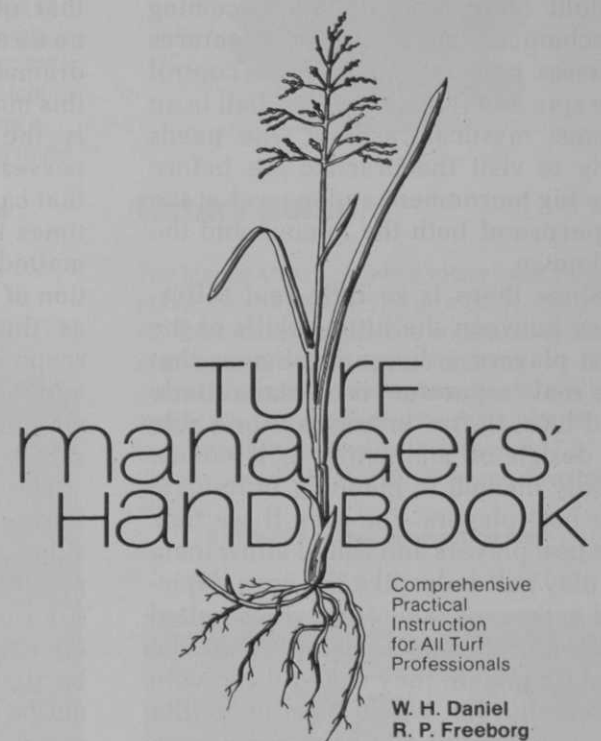
tional reality. It is possible that some organizations carry out the budgeting process in a proper way and yet face a host of problems. Budgeting is not a panacea for all the organizational problems. These articles should not give such a picture because it would be a mistaken view. If these articles make some golf course superintendents ask themselves, "Are we doing our budgeting right?", then the purpose of the articles would be served. □

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