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Some Behavioral Implications in Profit Planning and Control

Glenn A. Welsch

Comprehensive profit planning, since it represents a systematic approach to management, must take into account all reactions to that management. Of these none is more vital to the plan's success than the personal response of individual workers —

SOME BEHAVIORAL IMPLICATIONS IN PROFIT PLANNING AND CONTROL

by Glenn A. Welsch
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THE BEHAVIORAL overtones of profit planning and control are pervasive and constitute the single most important success (or failure) factor in the application of a comprehensive profit planning and control program.

The term *comprehensive* implies application of the broad concept of profit planning and control to all phases of operations of an enterprise within the context of the overall management process.[1]

Within this broad context we can view some of the pervasive behavioral implications of profit planning and control. The behavioral implications focus on both the opportunities and the problems of a comprehensive program. A central objective of a profit planning and control program necessarily must be to maximize the human resource through positive motivation. It is useful to look at the behavioral implications in two dimensions. One dimension relates to the individual manager and the other to the organization.

First, the individual dimension implies the sophistication essential to understanding the positive and negative motivations of managers (individually and as groups), to understanding their reactions in various contexts and their responses to various styles of leadership. More directly, we seek to understand the potential responses of the individual to a comprehensive profit planning and control program. In viewing the potential responses and motivations, one must remember that there are two sides to the coin: the supervising manager (me) and the supervised manager (him). When we become involved in a behavioral problem, the tendency is to concentrate on "him"; that is, we tend to focus on *other people,* trying to dissect them and contrive actions to motivate them. Of course, that may be a very fruitful endeavor; however, the other side of the coin (me) may be of much greater relevance in a given situation.

Simply, the other side of the coin implies a critical self-analysis or introspection, for it is there that we

[1] Welsch, G. A., *Budgeting: Profit Planning and Control,* Third Edition, Prentice-Hall, Inc., Englewood Cliffs, New Jersey, 1971.

frequently find a pervasive behavioral problem. The supervising manager tends to overlook this facet. When managers focus on human relations—how to get along with people, how to supervise people, how to exercise leadership, and how to motivate subordinates in a positive manner—both sides of the coin should be carefully analyzed.

Now let's turn our attention briefly to behavioral implications from the vantage point of the enterprise. In respect to comprehensive profit planning and control, we should recognize the essentially different problems posed at the various managerial levels in the organization. Thus, it appears reasonable to expect somewhat different behavioral perspectives and implications at the executive management level, the middle management level, the lower management level, and among non-managers.

Throughout this article it might be useful for the reader to keep in mind behavioral implications from the vantage points of both the individual and of the organization. With this background, we may consider some of the more important behavioral implications of a comprehensive profit planning and control program. For convenience, we will label each in a specific manner; the objective is to identify certain problem areas and to indicate briefly their significance.

System implications — There is wide recognition that the management process cannot be effectively performed in a completely random, ad hoc, unstructured manner. A certain degree of stability, structure, and consistency is essential. Comprehensive profit planning and control represents a systematic approach to managing; thus it has great potential for enhancing the essentials of structure, stability, organization, consistency, realism, and flexibility.

Alternatively, it may be used, or permitted, to produce inflexibility, to stifle change and innovation, to restrict managerial initiative, to induce unrealistic pressure, and to encourage management by the rule book. These diverse potentials pose serious and pervasive behavioral implications. The undesirable potentials are widely feared and resisted by managers—and others—since they are frequently observed, easily imagined, and widely discussed. On the other hand, the positive potentials require sophisticated understanding and are much more difficult to communicate convincingly.

Administration of a comprehensive profit planning and control program in ways to assure that the positive potentials accrue taxes the behavioral sophistication of a management perhaps more than any other endeavor. Thus, since profit planning and control relates intimately to the broad management process and to all levels of human endeavor in the enterprise, it has significant and complex behavioral overtones. By definition, management is a directive effort. It's an activity that involves the direction of other people and, to the extent that the manager engages in doing the work himself rather than directing the efforts of others, he moves from the role of the true manager to the role of the worker. Fundamentally, then, management involves the motivation of people and groups to attain desirable goals. The overriding goals necessarily are those of the enterprise. The explicit and implicit reward systems permeate these behavioral implications. Profit planning and control imposes specific goals on managers whose performance in turn depends upon those they supervise. Control is action directed toward attainment of those goals. Positive rewards occasionally are attached to attainment of goals (favorable variances), but more frequently, and unfortunately, negative rewards are attached to non-attainment (unfavorable variances). If negative rewards (both explicit and implicit) dominate exclusively, as they so frequently do, undesirable behavioral implications can be expected. The point is that the tendency is to focus exclusively on the

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unfavorable and overlook the favorable.

In extreme situations, this may cause a manager to resign, be discouraged, or even to sabotage the system. He may even solicit help from others to sabotage the profit planning and control system. The profit planning and control approach to managing opens the door to many facets of motivation both positive and negative. Sophisticated adaptation and utilization of the system can avoid these negative results and replace them with a high level of positive motivation. From this point we must be unyielding. Fundamentally, it is not the system, though, that commits the managerial sins, but rather the managers themselves. They really don't need profit planning and control to generate the negative reactions that have been enumerated.

Goal orientation—Fundamentally, for continued motivation of managers there are two goal orientations that must be harmonized in every enterprise, and the profit planning and control program tends to bring them into focus. One goal orientation is that of the enterprise and the other that of the individual manager. To be motivated positively, the individual manager must be able to harmonize his long-range personal goals with those of the enterprise—economic, social, and ethical. Necessarily, the business enterprise goals must focus on profits, earnings per share, cash flow, return on investment, growth, and social responsibilities. The goals of the individual manager normally focus on financial rewards, accomplishment, meaningful activities, recognition, opportunities for growth, and pride in affiliation.

It is not difficult to perceive that these respective goals may be out of phase in many situations. Thus an important behavioral facet involves manners in which these two goal orientations may be brought into long-run harmony. Fundamentally, ownership establishes the broad goals such as return on investment. From this point of departure, the management is directly involved in goal setting: the attitude of the company toward its employees, customers, and society in general and specific goals and subgoals within the enterprise. The greater the extent that the individual is involved in the process of goal setting, the greater the opportunity for goal congruence. The effective participation of managers at all levels influences both goal orientations and tends to bring them into harmony so that there is a unity of purpose. A leading psychologist made this statement, which is particularly relevant to the point:

"The key problem facing a mature managerial group is to define a common purpose—a goal which excites the imagination of the rank and file and which is attainable if they go after it as a team. To be exciting, it must either be something new that will give them a distinction they can share, or something hitherto considered too difficult or even impossible, so that they can feel that they are spearheading a breakthrough for the rest of their industry. Morale is, after all, a matter of feeling that one has a common cause with his organization. It is increasingly apparent today that what many people want most is a sense of accomplishment—a feeling that what they are getting paid to do helps to make the world better and isn't just a meaningless exercise for the sake of money.

"The standard against which mature management judges its performance is the ultimate potentialities of its own organization—not the performance of its competitors.

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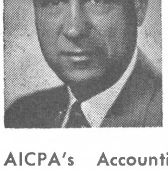

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The essential obligations of an enlightened management are to define the potentialities, to create a working atmosphere in which men will want to strive toward them, and to attract the kind of men who can and will participate in such a growth process. Psychology can help management to approach these goals—but it cannot achieve them for management by itself. Despite all the aid and comfort psychology can bring, management will have to provide its own salvation."[2]

Attitudinal impacts — Numerous research studies by industrial psychologists have confirmed the significant impact of the attitudes of higher levels of management on lower levels of management. The attitudes of the higher manager are very pervasive in that they tend to permeate the lower levels of management. Thus, in a comprehensive planning and control program the attitudes of the higher management toward planning, cost control, participation, follow-up, and other important facets of such a program become very important to its success. To illustrate some of the more important attitudinal impacts: A management may establish a procedure with much fanfare for participation in the planning process by lower levels of management and then proceed in various and sundry ways to make that participation ineffective (pseudo-participation). In the area of cost control, a higher management may be quite vocal concerning the importance of cost control and at the same time exhibit a complete lack of actual control on its own part of costs which it directly incurs. Similarly, a higher management may make absences and tardiness a significant issue and yet itself be the number one guilty party in this respect.

In situations of this type the lower managers very soon come to understand the difference between the "claimed" and the "real" attitudes of the higher manager. It appears realistic to assume that the lower managers will soon adopt the real (perceived) attitudes of the higher management as opposed to their claimed attitudes.[3]

In a comprehensive profit planning and control program a wide range of management attitudes comes into sharp focus and under observation throughout the firm. These attitudes relate to such fundamental behavioral issues as the role of the respective managers in planning, financial evaluation of effects of contemplated plans, controls, evaluation of performance, analysis of variances, corrective action, rewards, and confidence in subordinates. Clearly, the attitudinal impacts implicit in a profit planning and control program pose particularly pervasive and significant behavioral implications.

Participation—One of the foundations of effective profit planning and control is thought to be widespread and meaningful participation in the process on the part of managers throughout the enterprise. In planning, participation is thought to ensure better plans, to establish a common understanding of purpose, to facilitate communication of objectives and policies, and to enhance acceptance of goals throughout the organization. It is generally thought that control is enhanced by active participation on the part of all levels of management in the investigation of variances, evaluation and selection of appropriate alternatives, and the development of related policies. Thus, participation has come to be recognized as an essential to effective profit planning and control, and behavioral implications are posed on the part of both the supervisor and the supervised. A supervisor frequently experiences considerable inner turmoil in attempting to delegate participatory authority to subordinates. He may well experience an inner feeling that he is surrendering some of his authority and status. An insecure supervisor also tends to have extreme inner doubts in respect to communicating information to subordinates beyond the absolute minimum required. Then, too, participation imposes significant time demands and requires a particular sophistication on the part of the supervisor. On the other side, the "supervised manager" secretly may not want to participate in planning. He quickly perceives that participation in planning carries with it an added responsibility to share in the failures as well as the successes of decisions and that participation requires significant commitments of his time. Also, the supervised may not possess the broad perspective and competence required for effective participation. There are many other important behavioral facets of effective participation in a profit planning and control program. Psuedo-participation almost always creates negative motivation; alternatively, it has been empirically verified that meaningful participation in profit planning and control has favorable behavioral effects. For example, one study found that "if supervisors had almost complete say or quite a lot to say in setting budget allowances and spending the money budgeted to them, 78 per cent of the general foremen were very concerned with costs. Alternatively, if the supervisors had very little or no say in setting budget allowances and in spending money budgeted to them, only 20 per cent of general foremen were very concerned with costs."[4]

Line-staff relationships — Behavioral conflicts between line managers and staff personnel, generally "beneath the surface," have long been recognized as a critical management problem. In a profit planning and control program line-staff conflicts in goal setting, control actions, usurpation by staff of line authority, abdication to the staff by line managers of line responsi-

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[2] Gellerman, Saul W., *People, Problems, and Profit—The Uses of Psychology in Management,* McGraw-Hill Book Company, Inc., New York, 1960.

[3] Mann, F. C., and H. Baumgartel, *Supervisors' Views on Costs,* Office Management Series No. 138, American Management Association.

[4] *Ibid.* (adapted)

bilities, and communication breakdowns are common. On this point, a former president of the Financial Executives Institute stated:

"There is another enemy of successful budget practice which may well be the cause of more of the friction between budgets and people than all the other areas put together. I refer to the misconception on the part of controllers, budget managers, accountants, and other staff people concerning their part in the process.

"When a controller takes operating personnel to task for exceeding the budget, he is inviting trouble of the worst kind. His correct course is to report the situation to the responsible operating management and, if necessary, to the president, using the same figures and terms in each case. The problem then rests with the president and his operating subordinate, which is exactly where it belongs. It should be discussed and action determined in the direct line organization. No controller should permit himself to be placed in the position of representing the president in such matters—of giving approval to budget or disapproval to results. The same principle applies to all staff people concerned with the coordinating of the budget system, whether they report to the controller, treasurer, or factory accountant. There is impressive evidence that overzealous budget people have caused a great deal of mischief in this field, practically all of it unnecessary. They cannot be blamed individually, of course, for the failure of management to provide the principles needed for good budget practice. The remedy is in the eradication of a vicious set of faulty notions concerning the relationships of staff and line.

"Another misconception sometimes indulged in by budget men is that they are almost solely responsible for cost reductions; that they alone are expected to seek and find opportunity for cost savings, such as excessive waste, dispensable overtime, carelessness in handling tools, and so on. It is difficult to conceive of a practice that violates more completely the basic principles of good human relations."[5]

Aspiration level—The aspiration level is that level of future performance in a familiar task which an individual, knowing his level of past performance in that task, explicitly undertakes to reach.[6] Specifically, in respect to cost, the spending level which a supervisor (department head) accepts as realistic and which he strives to attain is his aspiration level. To clarify the point further we may identify three potential levels of cost performance:

(1) The budgeted level
(2) The aspiration level
(3) The actual level experienced in the recent past.

Since the aspiration level is the real inner goal that the supervisor accepts, an objective in profit planning and control is to bring the aspiration level into harmony with the budget level (or vice versa). Clearly a budget level significantly at variance from the aspiration level will have a negative or, at best, no motivational effect on the supervisor.

The aspiration level is affected significantly by past successes and failures and tends to be the same as the actual level of performance in the recent past. On the other hand, the budgeted level may affect the aspiration level: If the difference between the actual level in the past and the budget level is not too great, the aspiration level will tend to agree with the latter. If the difference is too great, the aspiration level may be unaffected or even lowered, resulting perhaps in sabotage of the standards. Failure to attain budget goals over a period of time will adversely affect the aspiration level. These statements

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[5] Pierce, James L., "The Budget Comes of Age," *Harvard Business Review*, Volume 32, No. 3.

[6] Stedry, Andrew C., *Budget Control and Cost Behavior*, Prentice-Hall, Inc., Englewood Cliffs, New Jersey, 1960.

may be subject to some disagreement; however, they do suggest that significant research in this area is needed to either affirm or negate them. They appear logical and, if essentially correct, have some important implications: (a) Realistic budget allowances, as opposed to optimistic or pessimistic levels, tend to maximize motivation; (b) concurrence through participation of the supervisor is important so that his aspiration level can be brought to bear in goal setting; (c) increases in the aspiration level of the individual manager are possible; and (d) the aspiration level of the enterprise as a whole will be affected by the aspiration levels of the individual managers.

Clearly, the concept of aspiration level poses significant behavioral implications in the budgetary process. Although limited research has been done in this area, there are too many unknowns at the present time for one to speak with confidence on the subject.

Pressure, a behavioral manifestation—Industrial psychologists have conducted several relevant studies on the behavioral effects of pressure in the management process. Consistent with these studies, casual observation alone indicates that most individuals and groups perform more effectively under certain amounts and types of pressure. Thus it appears that certain amounts and certain types of pressure are essential to effective managerial leadership. The significant problems posed in the managerial context concern the duration, extent, and types of pressure that tend to maximize continued motivation of the individual manager and the respective management teams. The effects of pressure are thought to be unique to the people involved and the prevailing environment. Pressure that is harsh, extensive, unrealistic, inconsistent, inflexible, and misunderstood very soon will push the individual or group to a critical antagonistic point. Certain elements of the profit planning and control approach have been used as extreme pressure devices to goad people into greater efforts. Unbiased analyses of such situations—and a number have been made—clearly show that the central problem is an insecure and/or unsophisticated manager.

Some years ago Chris Argyris published an item that dwelled on the undesirable effects of budgets on people; it concentrated primarily on pressure exerted in this manner.[7] Budgets provide a very handy tool, although not the only one available to management, to exert extreme pressure on people. In such situations, it appears there are two basic explanations. Perhaps the more fundamental one is that where we find extreme pressure in a company, we find a management (and individual managers) that is inept, insecure, and that has certain negative views toward subordinates in general. Another cause of extreme pressure in budget programs is the application of inappropriate budget techniques and unsophisticated applications of the techniques being utilized. It would appear that there is no reason why a profit planning and control program should not be used to impose pressures in a sophisticated way. In fact, it would appear that this is one of the essential management efforts; however, the attitudes and manners in which pressure may be exerted to attain positive motivation require a high level of sophistication.

Padding the budget—Padding the budget is a very familiar syndrome that is widely discussed, although not too fundamentally. It is generally recognized that budgets are padded for two basic reasons: (a) self-protection and (b) the potential effect on future budgets. When managers feel a need for self-protection to the extent that they are impelled to pad a budget estimate one can suspect that either (a) the system is inappropriate or (b) if appropriate, it is not being applied in a sophisticated manner. There is a central issue as to whether or not a favorable variance should be accorded the same degree of serious managerial concern as an unfavorable variance. If only unfavorable variances are accorded serious managerial concern then an invitation to padding is implicit in the situation. Alternatively, if favorable variances, irrespective of the reason, are always accorded high praise, a second implicit invitation to padding exists.

A relevant point seldom made is that perhaps the ideal situation is one in which there is neither a favorable nor an unfavorable variance since this tends to say that the premium is on the ability to plan realistically and effectively. These are unsettled issues; however, they are of such significance that much research on them is needed in order to improve their conceptual and realistic implications for the profit planning and control concept. In respect to future budgets, numerous examples can be cited that constitute budget padding. For example, there is the tendency to spend unwisely near the year-end in order "to use up all of my budget money so that my upcoming budget will not be reduced." This course of action reflects the tendency of higher management to base budget allowances on historical spending levels rather than on planned programs for the future. Another common situation is the fear of a lowering of the next budget if a manager performs too well.

We should recognize that there are effective behavioral approaches for minimizing the tendency to pad budgets.

Performance measurement — An important facet of a comprehensive profit planning and control program is a system of performance reports incorporating comparison of actual performance against planned performance for each manager (responsibility center) throughout the enterprise. These reports deal directly with the measurement of individual performance; hence they imply both a knowledge of what is good and bad performance and an

[7] Argyris, C., *The Impact of Budgets on People,* Prepared for the Controllership Foundation, Inc., at Cornell University, Ithaca, New York, 1952.

accurate measurement of actual performance. Fundamentally, performance measurement attempts to relate the inputs (generally costs) to outputs (goods or services). The effectiveness of performance is the relationship between these two factors. Those who tend to be incompetent and insecure tend to fear precise measurement whereas those who are competent and confident tend to welcome performance measurement. The competent person, in accepting performance measurement, will insist on precise, relevant, consistent, and open measurement. The profit planning and control approach focuses on the concept of a standard in the measurement of performance. Thus, the development of the standard (plan) poses critical behavioral implications since the concept of a standard requires the precise definition of (1) controllable versus noncontrollable factors, (2) the form of the standard, and (3) responsibility for establishing the standard. Acceptance of the standards, the manner of performance reporting, and the modes of investigating variations and evaluating alternatives all pose serious behavioral implications that are not clearly understood.

Resistance to change—Fear of change is one of the serious behavioral problems encountered in a profit planning and control program. It occurs not only when the program is initiated but over a period of time as improvements in procedures and approaches are implemented. Resistance to change is due to very deep-rooted behavioral causes. It is rooted in uncertainty, lack of confidence in the leadership, inadequate communication, questioning of motives, and insecurity. All too frequently changes are instituted that affect people in significant ways, but too little thought is given to communicating to those people the rationale for the change and the long-range impacts. The implications are not understood and distrust arises. Although much psychological research has been done in the general area of resistance to change, the specific behavioral implications in respect to a profit planning and control program need to be recognized and accorded further investigation.

More research needed

We have only suggested a few of the behavioral implications of a comprehensive profit planning and control program. Many other implications could have been pinpointed.[8] In closing, it seems reasonable to state that the behavioral implications of profit planning and control are of much greater impact than the technical, quantitative, and procedural implications combined. The behavioral implications require a degree of sophistication that many managements lack. There is a great need for more research oriented toward these specific problems in both their conceptual and practical settings. From both vantage points we should start with the fundamental nature of man and then place him in the context of a competitive, complex, and rapidly changing environment.[9]

In the last few years management has been involved in an explosion of very useful and complex mathematical applications to the management process. This trend will continue. The trends exhibited by the young people, the managers of tomorrow, suggest that the broad behavioral implications in the management process will come under much closer scrutiny. To be dynamic and progressive, a manager more and more must become a behavioral sophisticate. Enlightened behavioral sophistication will "pay off" no less than a shiny new product.

[8] For collections of recent articles see: Rappaport, Alfred, *Information for Decision-Making, Quantitative and Behavioral Dimensions*, Prentice-Hall, Inc., Englewood Cliffs, New Jersey, 1970, and Bruns, W. J., and D. T. DeCoster, *Accounting and its Behavioral Implications*, McGraw-Hill Book Co., Inc., New York, 1964.

[9] Knowes, Henry P., and Borje O. Saxberg, "Human Relations and the Nature of Man," *Harvard Business Review*, March-April, 1967.

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