

Lingnan University

Digital Commons @ Lingnan University

Bachelor Degree - Accountancy - Final Year
Project

Department of Accountancy

4-30-1999

A study of the importance of the budgeting and forecasting during recession in the hotel industry

Angel LEE

Sze Ka, Kathy LIN

Follow this and additional works at: https://commons.ln.edu.hk/acct_fyp

Recommended Citation

Lee, A., & Lin, S. K. K. (1999). A study of the importance of the budgeting and forecasting during recession in the hotel industry (UG dissertation, Lingnan University, Hong Kong). Retrieved from https://commons.ln.edu.hk/acct_fyp/7

This UG Dissertation is brought to you for free and open access by the Department of Accountancy at Digital Commons @ Lingnan University. It has been accepted for inclusion in Bachelor Degree - Accountancy - Final Year Project by an authorized administrator of Digital Commons @ Lingnan University.

LINGNAN COLLEGE
Department of Accounting and Finance
A Final Year Research Project

**A STUDY OF THE IMPORTANCE OF THE
BUDGETING AND FORECASTING DURING
RECESSION IN THE HOTEL INDUSTRY**

Submitted to Dr. Michael J. Gift
(Associate Professor of Accounting and Finance
Department)

Prepared by
Lin Sze Ka, Kathy 1093482
Lee, Angel 1011202

**A research project submitted in partial fulfillment of the
requirements for the Bachelor of Business Administration
(Honors) Degree Program**

30 April 1999

ABSTRACT

Nowadays, many organizations arouse the importance of budgets in their operation. For the hoteliers, the budgetary system is a powerful planning, controlling and motivating tool for them to predict the future sales volume and expenses. However, the unexpected tourism downturn in the second half of 1997 ruined their planning since no one could predict this event one year beforehand.

This project attempted to examine the hotel industry about which budgetary approach to be more popular in the hotel industry, the relationship between the participative approach and the budgetary slack, the basis for evaluating employees' performance, and the reliability and importance of budgets during uncertainty.

The findings showed that the hoteliers tend to use participative approach. However, there is no evidence to support the positive relationship between participation and budgetary slack. In addition, budgetary information forms a major part in evaluating employees' performance. Moreover, the reliability and importance of budgets are not directly affected by the time period but are affected by how the hoteliers see the functions of budget.

In conclusion, some recommendations such as, using the participative budgeting approach, setting up a bonus-based technique, developing an accounting information system, using the budgetary information on evaluation, and setting a realistic and challenging budget targets are made for improvement to the budgetary system.

ACKNOWLEDGEMENTS

We have to give our sincere appreciation to our supervisor Dr. Michael J. Gift of Accounting and Finance Department of Lingnan College, who initiated us into the right direction when we prepare the work, supervised and constantly made insightful comments and useful suggestions during the writing of this project. It is sure the report should have been far from completion and integration without his advice.

In addition, we would also like to thank the interviewees who have offered us their time and a lot of valuable information. They are as follows (in alphabetical order):

The Accountant, the Hong Kong Hotels Association

The Assistant Controller, the Kowloon Shangri-La Hong Kong

The Financial Controller, the Peninsula Hong Kong

The Financial Controller, the Park Lane Hong Kong

The Assistant Financial Controller, the Regent Hong Kong

The Controller, the Renaissance Harbour View Hotel Hong Kong

The Assistant Financial Controller, the Ritz-Carlton Hong Kong

The Controller, the South Pacific Hotel Hong Kong

Last but not least, we would like to express our thanks to the second assessor of our project, Mr. Shum Chun Yau, Clement, who gave us valuable comments and support during our research.

Angel Lee

Kathy Lin

TABLE OF CONTENTS

ABSTRACT	i
ACKNOWLEDGMENT	ii
TABLE OF COTENTS	iii
<u>CHAPTER</u>	
1. INTRODUCTION	1
2. OBJECTIVES	4
3. GENERAL LITERATURE REVIEW	6
3.1 Nature of Budgeting	6
3.2 Nature of Forecasting	7
3.3 Developing a Budget in the Hotel Industry	7
3.4 Advantages and Disadvantages of Budgeting	10
4. METHODOLOGY	13
4.1 Collection of Data	13
4.2 Sampling Design	15
4.3 Analysis Technique	15
4.4 Limitations	16
5. FINDINGS & ANALYSIS	18
5.1 Budgetary Approach	18
5.2 Budgetary Slack	42
5.3 Style of Evaluation	50
5.4 Importance and Reliability of Budgets	62
6. CONCLUSION	70
7. RECOMMENDATIONS	72
BIBLIOGRAPHY	
APPENDICES	
APPENDIX A APPLICATION LETTER FOR AN INTERVIEW	
APPENDIX B INTERVIEW QUESTIONS	
APPENDIX C SUMMARY OF FINDINGS	

INTRODUCTION

Nowadays, many organizations of any size use the management accounting for its operation. It is most likely that they tend to use the budgetary control as their accounting system. Budgeting acts as an essential role to transfer all elements of the strategic plan into concrete financial figures. It creates a standard for evaluating the performance for short-term purpose, usually one year. Besides, it helps to allocate limited resources more efficiently and effectively.

However, the entire budgetary process can be time-consuming and costly. Besides, the budgeting process may trigger numerous dysfunctional outcomes such as distrust, resistance, internal conflict and other undesired side effects. One may argue that the cost and time involved is not justified as the end result of the budget which is based on many unknown factors. There is also an argument that the budget encourages managers to spend up to budget more than is required. If the budget is used ineffectively, the organization may encounter many troubles and may worsen the operation of the organization.

On the other hand, humans ‘cook’ the budget and at the same time, humans use the budget. Budget has a direct impact on human behaviour as it is influenced by human

behaviour. This seems that budgeting and human behaviour has an interaction. It is interesting to study how the human behaviour influences the budget and on the other hand, how the budget affects human behaviour.

As the budget-setting is based on many unknown factors, people need to set up assumptions and predictions. If the environment is highly volatile, does it affect the ability of predicting the future and hence the reliability of budget?

Among all industries in Hong Kong, hotel industry seems to be a representative for the activities of all organizations in the territories. Within the industry, it implies almost all human activities, including clothing, dining and accommodation. Since the tourism is one of the Hong Kong's main revenue sources, the hospitality industry thus becomes vital to Hong Kong's economy.

Besides, the operation of hotel involves many fixed costs. The room supply is fixed all times and services cannot be invented. As services are intangible, this is difficult for anyone to measure and evaluate employees' performance. In addition, the nature of the hotel industry is service-oriented. This characteristic makes the human becomes the most important resources which determines organizational

effectiveness. As the hotel industry is labour-intensive with its distinctive characteristics, it is interesting to study how the hoteliers can manage and control the operations in order to survive or succeed in different period of time.

Furthermore, the hotel industry has experienced a difficult period. The industry suffered a setback in 1997 with the foreign-arrivals dropped 11.1% than those in 1996. According to the reports of the Hong Kong Tourists Association (HKTA), the average occupancy rate of the member hotels dropped to 76% in 1997 from 88% in 1996. The unexpected downturn in the second half of 1997 led almost all of the hoteliers suffered, especially for the budgeting committee. The suffering was resulted from the tourist boom in 1996 and the expectations of increased arrivals on completion of the new airports had led to an optimistic forecast for the whole year of 1997. During this period, the actual revenue was far from the hoteliers' expectation. Does the budget continue to serve its function? Does the importance and reliability of the budget being affected? So, the hotel industry is valuable for us to study.

OBJECTIVES

In this project, we are going to study the budgetary system and its problems in the hotel industry.

Basically, the budgeting can be divided into two approaches. They are participative and non-participative budgeting. Both approaches have their own advantages and disadvantages. One of the aims of this project is *to find out which approach is to be more popular in the hotel industry and, at the same time, the reasons for using the approach.*

As the budgets are set by the human beings, bias is inevitable since the estimation is based on personal judgement. The possibility of budgetary slack may be resulted. Therefore, the second objective is *to examine the existence of budgetary slack and the relationship between the participative budgeting and the propensity for the hoteliers to create budgetary slack.*

After the budgets being set, the ways in using the budget to evaluate the employees' performance can affect human behaviour, too. Our third objective is *to examine the basis for evaluating employees' performance.*

Since there was a fluctuation of the Hong Kong tourism in 1997, these uncertainties greatly affect the accuracy of the available information, and hence, the accuracy and predictability of the budgets. So we are interested *to investigate the extent of the reliability and the importance of the budgets in the hotel industry during tourism*

downturn.

The last objective of our report is to *recommend how the hoteliers can do and use the budgets more effectively.*

GENERAL LITERATURE REVIEW

“Good budgeting leads to good management, which leads to good business performance”.

Finney (1993)

3.1 Nature of Budgeting

A budget is usually defined in accounting literature as a “financial plan for the future.” It is a financial plan of a company for the period of a year, predicting financial results and the contents of the financial statements over that year and predicting in detail the pertinent financial results of all the organization elements of the company. Budgeting is the process of preparing budgets. The essence of these steps that a budget is: 1) a plan for the future; 2) a communications medium; and 3) a control mechanism.

Budgets serve several objectives: planning and coordinating activities, communicating and authorizing actions, motivating people, implementing plans, and controlling and evaluating performance. Whether it is a profit-oriented firm or a nonprofit organization, a small domestic corporation or a large multinational conglomerate, budgets are universally used to carry out management plans and decisions. Lately, budgets have been used increasingly as an instrument to motivate people.

3.2 Nature of Forecasting

A forecast is a type of budget, but is usually completed on a short-term basis and is generally much less detailed. A budget is usually completed up to a year ahead, and many factors may change which require a more up to date prediction of the level of business. It can be a daily, weekly, monthly or seasonally forecast.

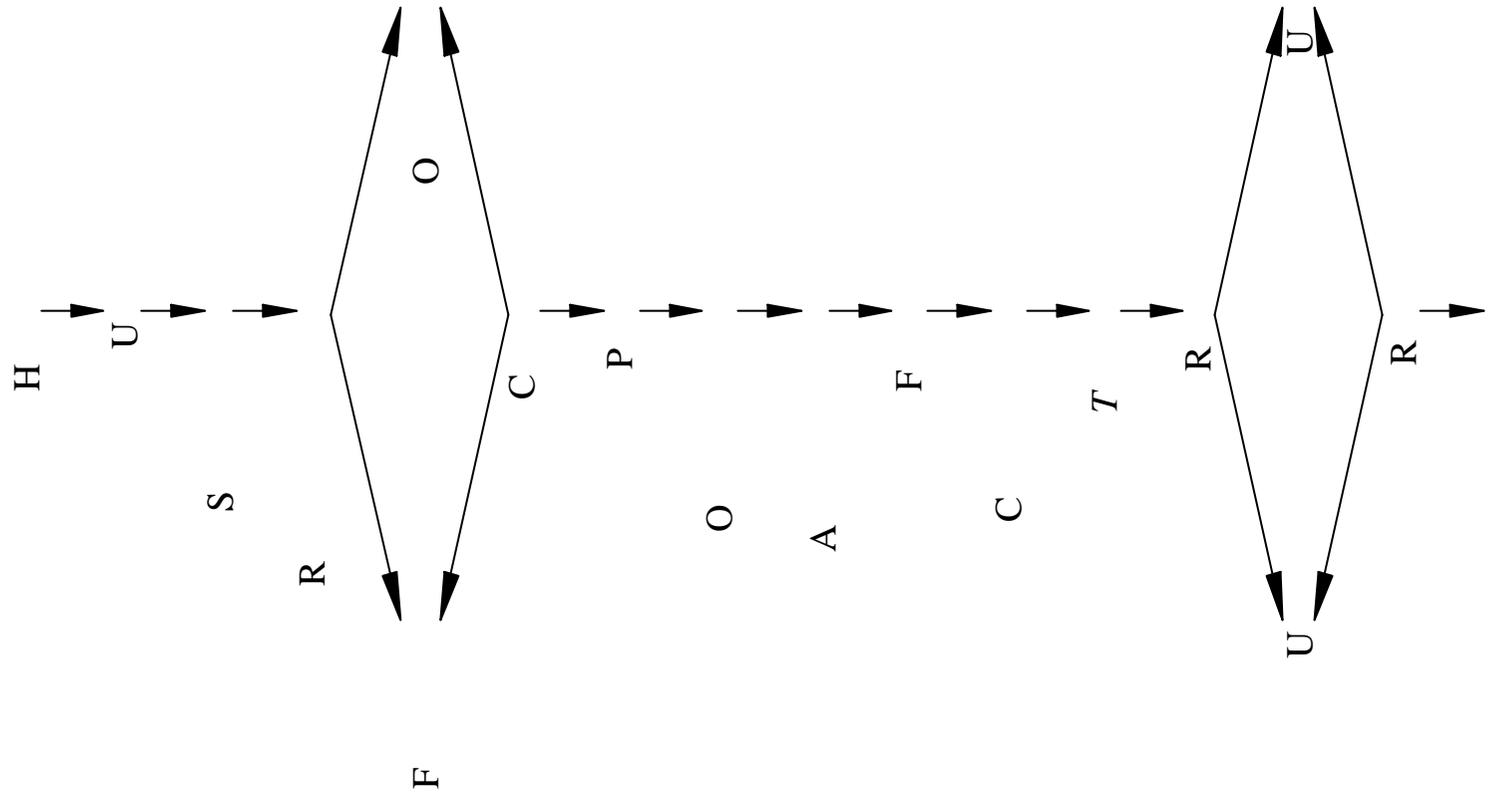
Forecasting enables managers to plan more effectively. It also enables the financial management to control more effectively. Besides, forecasting allows people to identify short-term problems, and hopefully to take some actions as a result in order to minimize their risks.

3.3 Developing a Budget in Hotel Industry

A budget is made by the cooperation with all departments in a hotel. It is a stage for collaborating information. Diagram 3.1 shows the stages in developing a budget for the hotel industry.

Before the commencement of the budgeting process, and before many of the departmental managers become involved, it needs to obtain certain information.

Harris (1992) mentioned three kinds of information should be considered. They are



market trends, expense trends and prior results.

Market Trends

This is probably the most important aspect of the budgeting process. We should determine:

- ✧ competition of other hotels;
- ✧ the prices that can be charged for the type of clientele to be attracted;
- ✧ inflation factor;
- ✧ new services/activities that can be offered

All this information forms the major part of the sales and marketing plan.

Expense Trends

Inflation factors also have a major influence on the level of expenditure that are permitted. This information will include predictions on the level of price rises of fresh foods, beverages, utilities and so on, as well as the projected increase in pay levels allowed.

Prior Results

In order to predict the level of business in the future, accurate records of prior

achievement are essential. This will include past departmental profit and loss reports, statistics on types of rooms and covers sold, sources of business and rates achieved.

However, we cannot always budget for what we want. There are various limitations on the level of business that can be achieved. Some of these are:

- ✧ **Capacity** - There are only fixed rooms and seats in residential establishment and in restaurants. It is impossible to increase the volume of sales except by raising prices.
- ✧ **Labour** - The availability and affordability of certain categories of staff may determine what type of operation you have. Such as the speed with which waiters serve customers can affect the volume of sales considerably.
- ✧ **Equipment** - The type of equipment available may restrict the service provided.
- ✧ **Management** - An increase in sales may be impossible as a result of the deliberate policy of a business.
- ✧ **Capital** - The cost of replacing furniture, fixtures and equipment can be very high and may not be justifiable.

3.4 Advantages and Disadvantage of Budgeting

Coltman (1994) stated the advantages as well as the disadvantages of budgeting. A

number of advantages accrue to an organization that uses a budget planning process.

- 1) Since the budgeting process involves department heads and possibly other staff within the department, it encourages their participation and thus improves communication and motivation.
- 2) In preparing the budget, those involved are required to consider alternative courses of action.
- 3) Budgets outline in advance the revenues to be achieved and the cost involved in achieving these revenues. Therefore, it creates a standard for comparison.
- 4) Budgeting forces those involved to forward-looking.

Obviously, just as there are advantages to budgeting, there are still some disadvantages. They include:

- 1) The time and cost to prepare budgets can be considerable. Usually, the larger the organization the longer the time.
- 2) Budgets are based on unknown factors that can have a big bearing on what does actually happen.
- 3) Budget preparation may require that confidential information be included in the budget.
- 4) The “spending to the budget” approach can be a problem. If an expense budget

is overestimated, there can be a tendency to find ways to spend the money still in the budget as the end of the budget period arrives. So that, it pretends the budget forecast is correct.

METHODOLOGY

4.1 Collection of Data

Primary Research

The primary research was conducted by the formal personal interviews with selected hotels in Hong Kong. Totally, seven hotels have been interviewed. Only five of them have been selected in our project. Two of the hotels were deleted because of the incompleteness and non-clarity of the interview results. Letters of application for an interview (see Appendix A) were sent to the hotels in advance and a well developed question guideline (see Appendix B) was prepared before the date of the interviews. The purpose of the personal interviews was to understand the budgeting system in the hotels and the problems they faced during the tourism downturn. A postal questionnaire survey method was not used because we could gain more valuable insights and more detailed responses from the personal interviews.

In addition, an informal personal interview was also conducted with the Accountant of the Hong Kong Hotels Association in early December. The aim of this interview was to gain the expert's opinions and another view on the background of the hotel industry.

Secondary Research

Secondary data was obtained through the following means:

Library Searching

An intensive study on the literature on hotel business and budgeting techniques were conducted. The purposes of the library search were firstly, to understand the characteristics of the hotel industry. Secondly, to identify the problems in the budgeting process in businesses. Thirdly, to compare and contrast with similar studies conducted before.

Government Departments and Other Organizations

Secondary data about the hotel industry and the tourism was obtained from various sources including the Hong Kong Tourists Association and the Hong Kong Hotels Association. Through this data search, we were able to obtain statistics of (1) the number of visitors visited Hong Kong, (2) the number and name of hotels in Hong Kong, and (3) the hotels' occupancy rate. These provided us the insight for current situation of the hotel industry.

4.2 Sampling Design

We have sent out 75 letters to the financial controller of all the hotels who are the members of the Hong Kong Hotels Association for an interview. The reason for choosing the financial controller to be our interviewees rather than the managers is purely because they are the experts in the financial sector. So that we can obtain more valuable information on the issue of budgeting. During the end of February and early March, we have interviewed the financial controllers of seven hotels. Only five of them were selected to be analyzed in this report. The criteria for the selection was based on the completeness of the interview results and the clarity of their answers.

4.3 Analysis Technique

Findings and analysis will be presented in Chapter five where the four objectives will be discussed one by one. In the chapter, we organized to discuss the issue of participative/non-participative budgeting approach first. Then, it follows by the issues of budgetary slack, style of evaluation, and the importance and reliability of budgets. Each subsection has its own literature review, findings from the five hotels and the analysis. The summary of the findings is shown in Appendix C.

To a certain extent, these four issues are interdependent. Some of the literature may be overlapped in the other sections. However, each section has its unique objective. The reason for the independent literature review is to provide an ease and convenience for readers to have a clearer concept on the issue we are discussing.

4.4 LIMITATIONS

In our research project, there are some limitations that may affect the reliability and accuracy of our study on the issue of budgeting system in hotel industry.

The Ability of Generalization

The ability of generalizing the whole hotel industry is limited since only five hotels have been studied. This limitation is made by the impossibility to interview all hotels. Firstly, it is costly to have interview with the hotels. Secondly, the response from the hotels also limited our choice and variety of the hotels being studied.

The Weaknesses of Interview as Research Method

The method that we used to gather the information has its own weaknesses. Firstly, as human beings, the interviewees might answer the questions with subjective manner and bias. Secondly, there is the possibility of misunderstanding of our

questions. Thirdly, the interviewees may be conservative and hide some facts. The findings may thus be less reliable and may not be able to show the real picture of his or her own hotel.

The Time Period of our Study

We focus mainly on analyzing the period after the transition of Hong Kong in order to see the effects of the sudden tourism downturn.

5.1 BUDGETARY APPROACH

5.1.1 LITERATURE REVIEW–BUDGETARY APPROACH

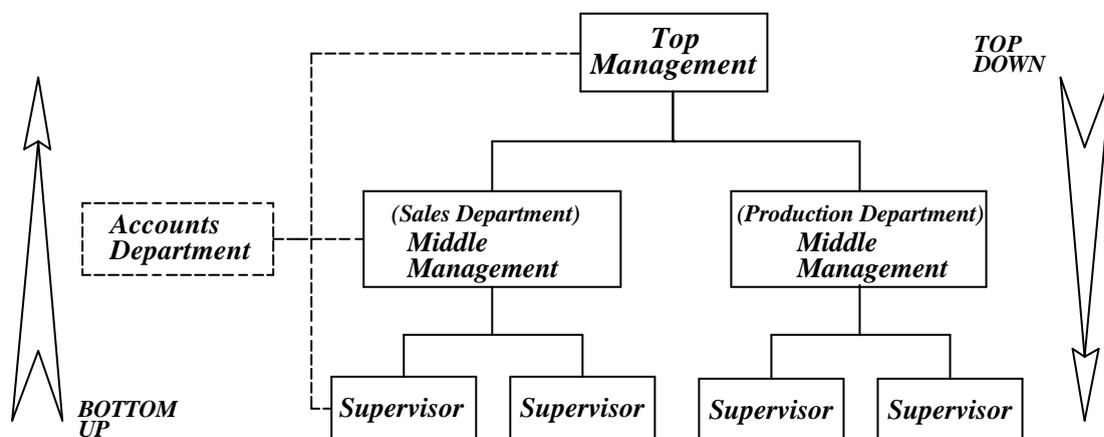
The behavioural implications of budgeting can be illustrated by examining two different ways in which budgets can be used to control the performance of department managers. One approach is to utilize comprehensive budgets prepared by the others to maintain detailed control over each activity in the manager's department. The budget is prepared by the higher level in the organizational structure. This traditional budgeting involves limited numbers of key person, such as board of directors, chief executive officers and higher level managers, in establishing financial objectives. Neither middle level managers nor supervisory level staff are substantially involved and make any important contribution. That is called the non-participative approach (also called "top-down" approach), see Diagram 5.1.1.

An alternative approach is to tell the manager what is expected of him in terms of the overall performance. This approach permits him to participate in the development of a budget that he promises to accomplish the desired results. Then, it allows him reasonably wide latitude on individual items within the budget-emphasizing, instead, his ability to meet the overall objectives. This participative approach is a process of joint decision making where top management

and the subordinates, especially the middle-level and lower-level managers (not only finance or accounting department itself), freely discuss budget goals and expectations and reach a consensus. This is called the participative approach (also called “bottom-up” approach), also see diagram 5.1.1.

These two approaches represent rather extreme alternatives and there are, of course, a number of possible budgeting variations which fall between them.

Diagram 5.1.1 Communication Flow of Budgeting Approaches



Garrison and Noreen (1994)

---- The dotted line indicates a staff support role

* The arrows show the direction of the informative flow. If the initial flow of budget

data is from lower levels of responsibility to higher levels of responsibility, these estimates are consolidated as they move upward in the organization (bottom-up approach), and vice versa.

Many researches showed the advantages of involving the employees in the process of budgeting. From a behavioral standpoint, the advantages of such participation are, *first*, it helps to provide challenge and a sense of responsibility. *Second*, it increases the probability that the goals of the budget will be internalized by the involved individuals, that is, they see those goals as their own goals. The process provides the intrinsic motivation to the participants. *Third*, it raises employees' morale and commitment. Employees develop a stake in the budget and tend to work more efficiently. It creates a "we" feeling in the organization. *Fourth*, it encourages cooperation among employees and makes them as partners in the undertaking. Being participants on an equal basis makes them feel important and gives them the feeling that what they do matters, and *fifth*, it allows employees experiencing job enrichment which gives them self-esteem and satisfaction and creates a positive attitude towards the firm. (Gyan 1993)

Many of the researches in motivation theory can be applied either directly or

indirectly to the budget process. Support for using participative approach can be found in both the needs hierarchy and the two-factors theory of human motivation.

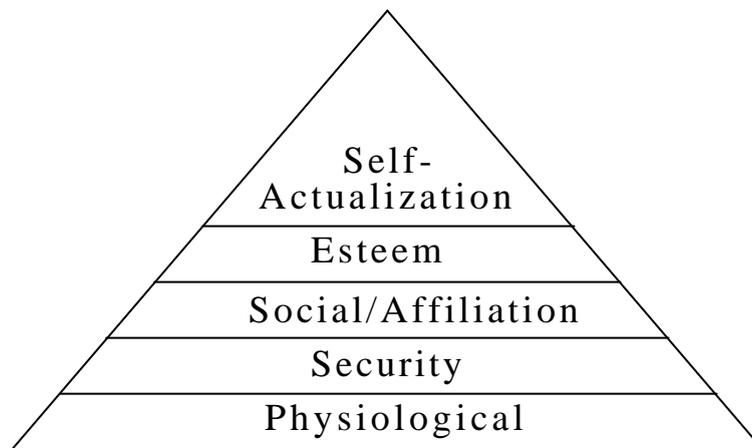
These two theories are briefly reviewed in the following.

Maslow's "Hierarchy of Needs"

One of the best known explanations of human motivation is provided by Maslow (1954). Maslow believed that people attempted to satisfy an *ascending* category of needs. He developed a motivation model based on a hierarchy of five levels of basic needs (Diagram 5.1.2). These are: (1) physiological—food, shelter, and the basic bodily needs; (2) safety—the need to feel protected, safe, and stable; (3) social/affiliation—the need for love, social interaction, and a feeling of belonging; (4) esteem—the need to feel that others recognize and respect one's accomplishments and self-worth, and (5) self-actualization—the need to be the best one can be, to reach one's potential through action. These needs are arranged in a hierarchy because Maslow believed that as a person satisfied lower order needs such as food, shelter, and some level of basic security, one's motivation towards those needs would diminish and be refocused toward accomplishing higher order needs. The five levels of needs are related to one another in a sequential fashion starting with the physiological needs at the bottom of the hierarchy and progressing upward through

the other levels until self-actualization is reached at the top of the hierarchy. In general, that once a lower level need is satisfied it no longer motivates, and that the only needs which motivate behaviour are those which are still unsatisfied.

Diagram 5.1.2 Maslow's Hierarchy of Needs



Maslow (1954)

According to Maslow, individual is fully satisfied when he/she has reached the self-actualization point. It means being involved in the creative expression of those things which each person finds to be the most gratifying for him.

Frederick Herzberg's "Motivation-Hygiene" Factors

Another significant development in the study of motivation is the "motivation-hygiene" theory of Frederick Herzberg. He found two factors affecting

a job situation, which he labeled *satisfiers* and *dissatisfiers*. The satisfiers were related to the nature of the work itself, i.e. job content, and to rewards that flowed directly from the performance of that work. The principal sources of satisfaction were achievement, recognition, the work itself, responsibility, and advancement. The dissatisfiers were related to the context rather than the content of the job. These factors included supervision, company policies, working conditions, salaries, status, and job security. He classified the satisfiers as motivators, since they were effective in motivating high performance and productivity. The dissatisfiers were classified as hygiene factors, and their function was viewed as primarily preventive in nature. The absence of the hygiene factors can adversely affect performance, but their presence will not necessarily improve performance. Effective motivation results from motivators, which give the individual a sense of personal accomplishment through the challenge of the job itself.

According to Herzberg, people are mostly motivated by the challenge of job, the achievement, involving in the work itself and the responsibility.

However, there are some disadvantages for the participative approach. The departmental managers may lack expertise in working out their budgets since they

are more specialize in operations. Besides, the confidential information may be disclosed. Moreover, managers tend to protect themselves by showing a defensive budget.

On the other hand, other researches showed some obvious advantages of the top-down approach. It is a less expensive approach and saves time since less people are involved in budget preparation. Another advantage of the approach is that the broad (company-wide) perspective brings to budgeting and the top management is less likely to suffer from narrow departmental considerations and politics.

Although there are many advantages in using the participative budgeting approach, it is not conclusive to say that participative approach is the best approach. The most desirable approach in any given situation will depend on a number of factors, including *organization culture*, the characteristics of the *particular tasks*, the *personality of the subordinates*, the *job time pressure* and *leadership styles* throughout the organization (Gyan, Webber, Filley, House, Kerr and Henri).

Organization culture

Organization culture refers to the collection of shared values and beliefs that gives a

feeling of community to the organizational members. To be effective, participation has to fit in the organizational culture. In an open and progressive organization, where there is mutual trust and communication, participation will flourish. However, in an organization characterized by heavy-handedness of the top management and undemocratic ways of doing things, the seeds of participation can be planted. (Gyan 1993)

Nature of the task

A simple, routine job will lend itself more to authoritarian behavior. Experiments show that when presented with simple, routine tasks, groups voluntarily form themselves into centralized wheel-like communication networks that facilitate rapid, efficient problem solving. Simple tasks call for simple (authoritarian) leadership. On the other hand, when complex and ambiguous problems need to be solved, experimental groups voluntarily organize into all-channel communication networks, which facilitate joint decision making (Webber 1975).

Personality of subordinates

Subordinates who are ego-involved in their work or who have a strong need for independence of action will tend to respond favorable to participation. Subordinates

who are not ego-involved or who have dependent personalities often respond poorly to participation (Filley, House, and Kerr 1976).

Job time pressure

Job time pressures affect the extent to which participation is possible. Many operational positions in hotels, such as banquet manager, have a very short time span between problem definition, solution and action. Often decisions must be made quickly or not at all, and therefore, there is only time for authoritarian behavior. (Henri 1978)

Leadership style

Leadership is the process of developing a common goal. Different managers have different leadership styles. There are aggressive managers, and there are weak managers. Both extremes could create problems in an organization. If the managers are not well trained in human relations, their behavior could discourage subordinates to come forward with suggestions and take initiative. Such managers, obviously, need training in winning trust and confidence of their subordinates. The overly aggressive managers can sometimes create an environment of rejection among the subordinates. Many of the subordinates may not be able to handle it and may feel

discouraged from participating in the future. (Gyan 1993)

In spite of these factors, a number of researchers and consultants observed that some firms professing to use participative budgeting were not really using it at all. Instead, they were involved in what has been termed “pseudo-participation”. A pseudo-participative process is defined as a budgeting process that leads subordinates to believe that they will have some influence on the budget that is set, but in reality, there is only less or no influence on the budget. (Argyris, 1952)

“True participation means that the people can be spontaneous and free in their discussion. Participation, in the real sense of the word, also involves a group decision which leads the group to accept or reject something new. Of course, organizations need to have their supervisors accept the new goals, not reject them; however, if the supervisors do not really accept the new changes but only say they do, then trouble is inevitable.”

Argyris (1952)

In this study, we are going to examine which budgetary approach to be more popular in the hotel industry and the reasons behind their choice.

5.1.2 FINDINGS

The followings are the results of the five hotels' interviews about the issue of budgeting approaches. Summary of the findings is shown in Appendix C, Table A.

The Kowloon Shangri-La Hong Kong

After talking with the Assistant Controller, we knew that he is responsible for reviewing the budget figures submitted by the division heads. After collecting the figures, he will check its reasonableness. If the figures are not reasonable, he will ask the heads to explain the factors. Then he will advise and review the budget.

From the interview, we also knew that his aims for allowing division heads to have their budgets are, firstly, to gain the commitment from his employees. Secondly, he requires them to have a thorough understanding about the past history of their departments in order to project their figures.

The Park Lane Hong Kong

The Financial Controller coordinates the whole process, gives guidelines and is responsible for double check with the figures submitted by the division heads. If there is a variance between the figures being submitted and his expected figures, he

will discuss with the division heads and compromise for the right figures.

Besides, he emphasized the cooperation among each department with the aim for team effort. So, he requires his subordinates to have their budgets by the team work within each division as well as the cooperation among divisions. So, the budget becomes more predictable.

The Peninsula Hong Kong

After interviewing with the Financial Controller, we found that the budgeting approach used by the Peninsula is distinct from the other four hotels.

In the budgeting process, it is clearly that he is the key person in the whole process. He drives the whole process with a sense of dominating it. He is the only person responsible for working out all departmental operating budgets except for the Food and Beverage Department. He admitted that he is not knowledgeable in that field and he believed that the F&B division head is more familiar with its operation.

He expressed that there is a major reason for the Peninsula not to involve the subordinates in preparing the budgets, the operational efficiency. He believed that

he is more specialized in accounting than the division heads. On the other hand, the division heads are more familiar with their daily operation. Because of this reason, he lets the division heads to focus on their daily operation rather than the figures. This can save much time instead of doing by the division heads.

The Regent Hong Kong

The Assistant Financial Controller acts as an advisor in order to give information and consolidate the figures. If there is a deviation from the one he thinks, they will have a discussion and then have a consensus on that issue. Basically, all the division heads prepare their budgets.

He emphasized the responsibility of the division heads for the budget. He stressed for two reasons. The first one is to train the managers to be multi-skilled. So it can partly reduce the workload of the financial controller. The second thing is that the division heads can make better management plan since they are more familiar with their daily operation than the controller or the top-management does.

The Renaissance Harbour View Hotel

From the interview, we found that the Controller of the Renaissance set all the budgets by himself two years ago. But in this two years' time, the Controller has

allowed the division heads to have their departmental budgets. He answered that he was forced to change since the participation approach becomes a common way for the budgeting process in the hotel industry. In the same time, he noted the advantages for using it. Gaining the commitment from the departmental heads is one of the noted advantages.

In the whole process, it is clear that he is responsible for monitoring the process, giving advice and finalizing the budget figures. If there is a gap between the views of the division heads and his, he requires the division heads to follow his figures. This is so because he believed that he was confident in his judgement and he was more experienced than anyone.

5.1.3 ANALYSIS

After the interviews with the five hotels, it is interesting to find that the duties of the financial controllers/assistant controllers are primarily to give advice, monitor the whole process and to finalize the budgets. Most but not all the hotels interviewed are using the participative budgeting approach. We found that four of the hotels are primarily using the participative budgeting approach (i.e. bottom-up), including the Kowloon Shangri-La Hotel, the Park Lane Hotel, the Regent Hotel, and the Renaissance Harbour View Hotel. Only the Peninsula Hotel is using the non-participative approach. However, it seems that not all the four hotels are really ‘participate’ in the budgeting process. The Renaissance Harbour View Hotel may be rather a pseudo-participation.

From the interview, we can clearly see that the Kowloon Shangri-La Hotel, the Park Lane Hotel, and the Regent Hotel allow the division heads to freely discuss budget goals and expectations in order to reach a consensus. We think that they are using a ‘real’ participative approach.

However, we found that the Renaissance Harbour View Hotel has limited participative elements. It seems that it is not really ‘participate’ in the budgeting

process. From the interview, we found that the financial controller admits the advantages of using participative approach. He also agreed with the increasing commitment from the departments. However, after a few minutes of discussion, it began to look as if the word “participation” had a rather unique meaning for the controller. Any figures deviated from his thought will always be followed him. In this sense, we don't think that the division heads are really having much influence on the budget process. Although he allows the division heads to do their budgets, the controller always rejects the new goals rather than accepts it. Therefore, we do believe that the Renaissance Harbour View Hotel is using a pseudo-participation rather than ‘real’ participation. So we doubt whether he can obtain the employees’ commitment.

Basically it is not so difficult to imagine why the hoteliers chose to use the participative approach. The four hotels primarily answered us for the similar reasons. We have also searched several studies, which have proposed that budget participation is positively linked to the employees’ performance, employees’ motivation and employees’ commitment. We summarize some of the factors why the four hotels use the participative approach.

Growth of the employees' motivation and commitment

From the interviews with **the Kowloon Shangri-La Hong Kong** and **the Renaissance Harbour View Hotel**, we clearly know that they are very concern about the commitment of their employees. They believe that the employees have a commitment and more incentive to fulfill the targets.

Ferguson and Berger (1986) mentioned that when both managers and employees participate in setting standards and targets, this could reduce the levels of anxiety and frustration. Thus, they are likely to exhibit degrees of *motivation*, resulting in higher degrees of reliance and *commitment* to the control system.

Improvement of the quality of work

Having the interview with **the Regent Hong Kong**, we discovered that the management places much emphasis on the responsibility of the division heads. So, this allows the mid-level managers and low-level employees feel a greater sense of responsibility and ownership. Greater *responsibility* benefits both the employees and the customers. Greater responsibility leads to a quick response to the guest requests, and in turn, employees are very satisfied by doing a good job. For example, a F&B head is confident in his decision by adjusting a comparative dishes in a fast changing

environment without asking the General Manager about this.

By allowing the department heads involve in the budget preparation process, their skills will be enhanced. It does not only increase productivity and *flexibility* to the hotel, but also gives employees the opportunity for advancement. Participating in the budgeting process can provide chance to train up the financial budgetary of the division heads. This can contribute the subordinates to broaden their range of skills.

Growth of the cooperation among employees

Having team effort is the main purpose of using participative budgeting of **the Park Lane Hong Kong**. We believe that since the Park Lane is an independent hotel, all the operating profit or loss will be borne by itself. Thus, the management tries to develop a culture of esprit de corps in order to obtain a strong sense of loyalty from the employees.

As Ferguson and Berger (1986) claimed that participation increases *group cohesiveness* among the individuals involved in budgeting if the group is positively inclined toward the budgeted goals.

A sound participatory budget would affect the quality of other work. A typical example is that hotel has been benefited from better team effectiveness and improved communication within organization. Team effectiveness allows higher productivity in organization, sharing goals and reducing conflicts.

Recognition of the local needs

We noted that **the Regent Hong Kong** and **the Kowloon Shangri-La Hong Kong** stresses many advantages for using participative budgeting approach. They believe that the operational managers are the only people who can have a *thorough understanding* about their daily operation. Neither the General Manager nor the senior managers have a thorough understanding about the front-line situation.

“The employees of a company are not the right people to determine strategic direction, but they will often have well informed views on the calibre of those who run it.”

Kay (1996)

Schmidgall (1987) commented that manager’s ability is to recognize problems specific to his company as an advantage of bottom-up budgeting.

Garrison and Noreen (1994) claimed that the person in direct contact with an activity is in the best position to make budget estimates. Therefore, budget estimates prepared by such persons (mid-level managers) tend to be more accurate and reliable.

After analyzing the reasons for the four hotels to choose the participative approach, it is no doubt that they can obtain many advantages from it. It seems that the participative approach is favourable to the hotel industry. However, the Peninsula Hotel, one of the top hotels, chose to use another method. We are now going to examine why the Peninsula Hotel chose to use the non-participative approach.

From the interview with the Financial Controller, we noted that he pays more attention on the operational efficiency. He mentioned that the operating managers are expertise in their operational issues but not in the financial issues. He thought that although the participative approach gets the managers involved in the process, it is a waste of time and inefficient. It seems that democracy leads to inefficient since the time wastes in gathering agreement among employees. On the other hand, autocracy leads to efficient since one's words represents all decisions. So, when those who emphasize the operational efficiency is better to do the budgets by the

financial controller himself rather than the departmental heads.

Besides, we find out some other reasons why the Peninsula uses the non-participative approach. It may be the reasons of different leadership styles, personality of subordinates and organizational culture from the other four hotels.

If the leadership style of the Peninsula Hotel is rather authoritarian, then the top management tends to impose the budgets from the top to the bottom. It gives no chance for the subordinates to come forward with suggestions and take initiative.

Besides, if the employees of the Peninsula have dependent personalities, then they tend to desire a non-participative approach since they are not so initiative and largely rely on the guidelines imposed by the top management. Furthermore, if the organizational culture of the Peninsula is the intervention by the top management, then it is difficult for her to implement the participative approach since it is not really democratic for the employees in doing things.

Limitations to the participative approach

From the interviews with the Renaissance Harbour View Hotel, participative budgeting is now reasonably well accepted by the hotels. It seems that the

participative approach represents a substantial improvement over the traditional and authoritarian practices. Nevertheless, participative budgeting has certain problems and limitations.

Lack of expertise

It was clear from the interview with the Financial Controller of the Peninsula Hong Kong that the division heads lack experience and expertise in dealing with the financial data. This hinders the accuracy and efficiency of doing the budgets.

From the studies of Batty 1970 (in O’Dea 1985), recognised two major difficulties may confront any participative budget planning scheme. Firstly, the participants may lack expertise required for comprehension of the range of the factors to be balanced in budget planning. Secondly, they may be limited in their ability to understand the need for identifying the limited factors, unable to comprehend more sophisticated forecasting techniques and may be unfamiliar with the broader economic and environmental factors affecting their operation.

Disclosure of confidential information

There is a lack of privacy through slippage into informality. The problem would

extend to take authoritative-sounding misinformation passed on through informal channels. In a worse case, people may pass the hotel's confidential data to their competitors or peers. As a result, lower productivity and morale will be resulted.

Existence of 'Protective' behaviour

It may create an unfair situation to department heads who manage their departments in very cost-effective manner, but they are not as capable as others in documentation and defense of their budgets. They might thus find themselves outranked by other department heads who are less cost-effective.

Presence of accounting reserves-defensive tactic

Some irresponsible managers may make the overstatement of expense forecasts and the understatement of revenue in order to reserve buffer from the wrath of top executives when problems occur. In tough environments, managers may set unachievable budgets to divert attention away from current poor performance.

In the event of mid-level managers used incremental approach to budget setting, which is based on the assumption that a budget will grow each year as a result of inflation or with the provision for 'natural growth', as a result, gradual changes in

the business may be overlooked. This approach ensures that previous overspends and inaccuracies are compounded each budget period. (A detailed study will be continued in the section 5.2)

After examining the two approaches, there is no definite answer which method is more appropriate. It appears that those selected methods should be consistent and reasonably matched with the existing hotel's environment. Besides, it must be based on the views of the hoteliers about the cost and benefits for participative and non-participative budgeting approach. We can see that whatever methods the hotel interviewees used, they still have a sound business history records.

5.2 BUDGETARY SLACK

5.2.1 LITERATURE REVIEW–BUDGETARY SLACK

The literature on organizational slack shows that managers have the motives necessary to desire to operate in a slack environment. The literature on budgetary slack considers the budget as the embodiment of that environment and, therefore, assumes that managers will use the budgeting process to bargain for slack budgets. As stated by Schiff and Lewin (1970), “managers will create slack in budgets through a process of *understating revenues and overstating costs*.” The general, definition of budgetary slack, then, is the understatement of revenues and the overstatement of costs in the budgeting process.

Evidence of budgetary slack has also been reported by others. Lowe and Shaw (1968) have shown that in cases where rewards were linked to forecasts, sales managers tended to distort the input information and to induce bias in their sales forecast. Lowe also pointed out that “the rational economic behaviour of individual managers will be motivated by a desire to strike a balance between present security in retaining their job, and increasing future income. A manager in the budgeting process, may reason that a conservative forecast (i.e. intentionally understate the revenue forecasts than the true expectation, in the same time, overstate the cost forecasts than the true

expectation. So that, it gives flexibility to the managers and offers a cushion for covering errors and shortfalls.) increases the likelihood of achieving a favourable budget performance in the coming budget period, and therefore his superior's approval then, but the cost of possibly disappointing his superior now with the size of his present forecast.”

Slack creation is a generalized organizational phenomenon. Many different organizational factors have been used to explain slack creation, in particular, organizational structure, goal congruence, control system, and managerial behavior. Belkaoui (1994) mentioned that the budgetary slack may occur in a participative organization. It may be due to the conflicts that arise between the individual and organizational goals, leading managers intentionally to create slack.

The budgeting system has been assumed to affect a manager's propensity to create budgetary slack, in the sense that this propensity can be increased or decreased by the way in which the budgeting system is designed or complemented.

The creation of slack may occur whether or not the organizational is based on a centralized or decentralized structure. The three studies made by Onsi (1973),

Cortland and Cammann (1976), and Merchant (1985), provide evidence that participation may lead to positive communication between managers so that subordinates feel less pressure to create slack. However, Lukka (1988) argued that a high degree of participation gives subordinate managers the opportunity to contribute directly to the creation of slack, and vice versa. When participation is low, the prospects for subordinates' building slack into their budgets are restricted.

In this study, we try to find out the relationship between the participation and the propensity for the hoteliers to create budgetary slack. Besides, we are going to find out the reasons behind it.

5.2.2 FINDINGS

In the interviews, we try to ask the financial controllers/the assistant controllers about the propensity of creating budgetary slack in their hotels. Summary of the findings is shown in the Appendix C, Table B.

Three out of the five hotels admitted that there is a propensity for employees to understate revenues and overstate cost when setting their budgets. These hotels are the Kowloon Shangri-La Hong Kong, the Regent Hotel and the Renaissance Harbour View Hotel. However, the other two, the Park Lane Hong Kong and the Peninsula Hong Kong, denied the happening of budgetary slack in their hotels.

Although the Financial Controller of the Park Lane Hong Kong didn't think that the happening of budgetary slack in his hotel, he recognized that there would be some probability that the division heads would estimate the figures wrong because of the missing information and the wrong perception. On the other hand, the financial controller of the Peninsula Hong Kong hesitated and answered that there was no budgetary slack in his hotel.

5.2.3 ANALYSIS

It is interesting to find out the relationship between the participation and the propensity of creating budgetary slack after the interviews. From the previous section (section 5.1), it is clear that the Kowloon Shangri-La Hong Kong, the Regent Hotel and the Renaissance Harbour View Hotel are using the participative approach. At the mean time, we found that they are facing the problem of budgetary slack. In this situation, we propose that there is a positive relationship between the participation and the slack.

On the other hand, this assumption can also be valid in the Peninsula Hong Kong. Since the management uses the non-participative approach, there will be no budgetary slack in the budgeting process. This is matched with the idea of Lukka (1988) that “a high degree of participation gives subordinate managers the opportunity to contribute directly to the creation of slack, and vice versa.”

However, we cannot assert that there is a definite positive relationship between the participation and the budgetary slack since there is an exception case of the Park Lane Hong Kong. In the study of the Park Lane Hong Kong, its participative approach does not lead it to have a budgetary slack. On the certain extent, it may be

the same idea of Onsi (1973), Cammann (1976) and Merchant (1985).

In the following paragraphs, we try to explain the assumed positive relationship of participation and slack for the three hotels with the help of previous literature. The forming of budgetary slack may be the results of an interaction of information asymmetry, budget emphasis, and participation. Baiman and Lewis (1989) mentioned that if budget emphasis and information asymmetry is high, subordinates are likely to attempt to negotiate slack budgets. Besides, Belkaoui (1994) mentioned that risk-averse and less self-esteem individuals may have greater propensity to build slack, too.

Budget Emphasis

It appears that the reason for the employees of the Kowloon Shangri-La Hong Kong, the Regent Hotel and the Renaissance Harbour View Hotel to build slack in their budgets is to enhance their compensation prospects. Since these three hotels use budget variance as the performance evaluation, therefore, the subordinates perceive their rewards as dependent on budget attainment. These results can be explained by Lowe (1968), “the rational economic behavior of individual managers” As a result, they may try to build slack into their budgets through the participative process.

On the other hand, if the employees are based on a budget-based evaluation method (that is, where employee compensation is contingent on meeting the performance standard), it imposes a risk on the employee since job performance can be affected by a host of uncontrollable factors. Consequently, risk-averse individuals may resort to slack budgeting through systematic distortion of input information. In practice, moreover, any enhanced risk aversion would lead the employee to resort to budgetary slack.

Information Asymmetry

Besides, in the participative budgets, the operational managers prepare the budgets because they are more familiar with the daily operation than the senior managers. Information asymmetry exists only when subordinates' information exceeds that of their superiors. Since the senior has the opportunity to access to local departmental information, this may reveal some of their private information that may be incorporated into the standards or budgets against which their performance would be assessed. So sometimes the subordinates may misrepresent or withhold some of their private information, which could lead to budgetary slack.

Self-Esteem

Belkaoui (1994) found that persons who have low opinions of themselves are more likely to cheat than persons with higher self-esteem. A person's expectations can be an important determinant of his or her behavior. A negative impact on self-esteem can lead an individual to develop an expectation of poor performance. At the same time, the individual who is given negative feedback about his or her self-esteem would be more risk averse than others and would be ready to resort to any behavior to cover the situation. Consequently, the person may attempt to distort the input information in order to have an attainable budget.

It does appear that participative budgeting may allow subordinates to have a greater opportunity to set up their favourable budget targets in some of the hotels, such as the case of the Kowloon Shangri-La Hong Kong, the Regent Hotel and the Renaissance Harbour View Hotel. However, it cannot be asserted that there is a positive relationship between participation and budgetary slack. The budget emphasize, information asymmetry, risk-averse individuals, and less self-esteem subordinates are our proposed reasons for their creation of budgetary slack.

5.3 STYLE OF EVALUATION

5.3.1 LITERATURE REVIEW--STYLE OF EVALUATION

In order to motivate the employees to do the best, there is a need to give them rewards on achieving satisfactory results. However, different styles of evaluation affect human behaviour. So, it is better to choose an approach which can motivate the employees.

Hotels provide extensive services which are intangible. It is difficult to measure the quality of employees' performance because of the lack of quantitative measurement.

However, the budget reports provide a quantitative measurement for evaluating employees' performance. But Nebel III (1991) stated 'an easily determined quantitative measurement of performance may not be the best measure.' Thus, we are interesting to examine the basis for evaluating the employees' performance.

Hopwood (1972) investigated the effect of how to use the budget performance information. In the study of Hopwood (1972), he identified three styles of evaluation:

1. **Budget constrained style**

‘The manager’s performance is primarily evaluated upon the basis of his ability to continually meet the budget on a short-term basis.’

2. **Profit conscious style**

‘The manager’s performance is evaluated on the basis of his ability to increase the general effectiveness of his unit’s operations in relation to the long-term purposes of the organizations. And the budgetary information has to be used with great care in a rather flexible manner.’

3. **Non-accounting style**

‘The budgetary information plays a relatively unimportant part in the superior’s evaluation of the manager’s performance.’

Table 5.3.1 shows the human effects of the three styles of evaluation. The ‘budget constrained’ and ‘profit conscious’ styles of evaluation result in a higher degree of involvement with costs (i.e. controlling expenses) than the ‘non-accounting’ style. But only the ‘profit conscious’ style can succeed in attaining this involvement without incurring either emotional costs for the managers or defensive behaviour

which is undesirable from the company's point of view.

On the other hand, the 'budget constrained' style leads the employees to widespread tension and worry about the job since they think that the evaluation is unjust. In order to meet the budget, they may manipulate the accounting reports and even make decisions which are less innovative and which, at times, increases the total processing costs for the company as a whole. Besides, this approach even worsened the relationships with supervisors and colleagues.

On the contrary, all these problems can be avoided by using the 'profit conscious' style and at the same time, which can ensure the managers' to concern the financial aspects. This seems that the 'profit conscious' style is more flexible. Nevertheless, Hopwood (1972) showed that the budgetary information is of primary importance that influences all aspects of the managers' behaviours.

Table 5.3.1 A summary of the effects of the three styles of evaluation

	<u>Style of evaluation</u>		
	<u>Budget</u> <u>constrained</u>	<u>Profit</u> <u>conscious</u>	<u>Non-accounti</u> <u>ng</u>
Involvement with costs	High	High	Low
Job related tension	High	Medium	Medium
Manipulation of the accounting reports	Extensive	Little	Little
Relations with the supervisor	Poor	Good	Good
Relations with colleagues	Poor	Good	Good

(Hopwood 1972)

However, Hopwood's (1972) study did not directly test the relationship between the evaluation style and managerial performance. He stated that, 'the presence of extensive manipulation in some of the reports made the accounting information unreliable for this purpose and given the subject of the research, it was difficult to revert to subjective assessments.'

Using the budgetary information can be as an unambiguous measure to evaluate the subordinates' performance. This seems that it is good for the employees to understand the targets and it pushes them to do well. The 'budget constrained' style will lead to role conflict and role ambiguity. Conflict and ambiguity will cause managerial stress, tension and anxiety. It is argued that dysfunctional behaviour is a

consequence of managers trying to cope with this stress and tension. (Hopwood 1972) It is not a surprise that the employees put effort to find the ways such as the manipulation of accounting reports and the creation of budgetary slack to win the 'budget emphasis' game.

Lowe & Shaw (1968) also concerned about the budget emphasis and human behaviours. Their study found that sales managers engaged in dysfunctional behaviour as a response to the firm's budget-based rewards system. They found that while involving sales managers in the budgetary process made best use of their local knowledge, it, however, also provided them with the chance to bias their sales forecasts and hence built budgetary slack. Dysfunctional behaviour, and in particular invalid data reporting (IRD), was found that to be a result of budget emphasis combined with budgetary participation.

Consistent with Lowe & Shaw (1968), Schiff & Lewin (1968) also suggested that budgetary slack is a normal part of the traditional budgetary process where a high emphasis is the norm. They found that such dysfunctional behaviour occurs in all companies.

5.3.2 FINDINGS

The summary of the findings is shown in the Appendix C, Table C.

The Kowloon Shangri-La Hong Kong

The Assistant Controller emphasized the importance of meeting the budgets and forecasts. When using the budget reports as an evaluation method, all the department heads will look thoroughly about the current situation and the operations of their departments in order to meet the budgets and forecasts. However, if it is difficult to have a prediction beforehand, he will consider employees' performance as well.

The Park Lane Hong Kong

The management evaluates the employees' performance by concerning the flow of the business, paying not much concern on meeting the budgets. But the Financial Controller didn't comment the uselessness of the budget information. Since the objective of the hotel is customer-oriented, the hotel needs to retain its image for good quality of service. Thus, they would be flexible to use all available information, not only budget reports, to evaluate the employees' performance.

The Peninsula Hong Kong

The management uses the ‘profit conscious’ style. The financial controller explained that the image as the top of the tree makes them put effort to retain the image and reputation for its good quality of service. So, the service provided by its employees are greatly concerned. Thus, when evaluating the employees’ performance, it would base on both the budget information and their performance.

The Regent Hong Kong

The management primarily uses the budget variance as the main source for evaluating employees’ performance. The Assistant Financial Controller thought that it is the best approach to comment on the subordinates’ performance with comparing the actual results with the budgeted figures. However, he admitted that when it is during uncertainty or fluctuation of the environment, the failure to meet the budget may not be the incompetence of their employees. So, when evaluating the employees’ performance, the Regent Hong Kong will find out the factors causing the great variance in order to see whether it is the responsibility of the employees.

The Renaissance Harbour View Hotel

The Renaissance Harbour View Hotel uses the ‘budget constrained’ style of

evaluation. He continued to say that when the budget targets become unrealistic and unattainable, he will compare with the forecasts since which has a relatively higher predictive power than the budgets. He thought that comparing the actual results with the standard (i.e. budgets or forecasts) is the best tool to motivate the employees. Besides, it is the easiest way to judge their performance. However, there are defects. The employees may only concern the numbers and figures. They may neglect the objectives of the company. If the employees overemphasize to meet the budget, they may fail in providing service.

5.3.3 ANALYSIS

After interviewed with the financial controller/assistant controller of the hotels, we found that three of them, the Kowloon Shangri-La Hong Kong, the Regent Hong Kong and the Renaissance Harbour View Hotel use the ‘budget constrained’ evaluation style. The other two hotels, the Park Lane Hong Kong and the Peninsula, use the ‘profit conscious’ style of evaluation. And none of them use the ‘non-accounting’ style. It appears that the budget information is useful when evaluating the employees’ performance.

Besides, it is interesting to find that the Renaissance Harbour View Hotel uses the budget variance style at any time. It is largely because the Renaissance is not position itself at the top of the hotel industry. Thus, it may pay less focus on the quality of its service but concern more on the figures. It may be the reason why it chose to use the ‘budget constrained’ style. On the other hand, since the purpose of its budget is to gain commitment from employees (mentioned in section 5.1), the employees will try their best to meet the standard. So, the ‘budget constrained’ style helps the employees notify the importance of meeting budgets.

However, high budget emphasis may give high pressure to them. This will create an

unfriendly and high-tension climate. The relationship between employees will be poor. This seems that high budget emphasis may lead to dysfunctional behaviours.

With the findings from our interviews, we can conclude that most hoteliers use budgetary information to evaluate the employees' performance. All of them agreed that the budget report is a kind of benchmark for analyzing the employees' performance. However, most of them would consider the real situation and environment when there are uncertainty. As the special nature of the hotel industry, it is difficult to measure the quality of service. Thus, it seems that using budgetary information as a standard in comparing with the actual results is an appropriate way on evaluating performance. This is not surprising that the hoteliers use budgetary information as a basis for evaluation no matter they have chosen the 'budgeted constrained' or 'profit conscious' styles.

Nevertheless, when using budgetary information, it is important to develop a realistic and achievable budget targets.

'Where the difficult goals was seen as a challenge, actual performance was better than target. But where the difficult goal was

viewed as impossible, performance fell below even the normal goal.'

Buckley and Mckenna (1984)

Thus, it seems that when the budget targets are attainable and challenging, it can motivate the employees to provide good performance. But when the budget goals are unrealistic, it may lead the employees to have poor incentives affecting their performance. Therefore, during uncertainty period, the budget targets may become critical and may be unrealistic. Then it is unfair to use the 'budget constrained' style of evaluation. This would lead the employees to have poor incentives to work hard and even do some dysfunctional behaviours such as manipulation of the accounting reports.

On the other hand, the users of the budgets should acknowledge that when sales and profit decreased and the economic outlook appeared gloomy, budget pressure was increased. Argyris (1968) reported that the budgetary pressure was influenced by general leader style. For instance, an aggressive and domineering type leader was likely to project an aggressive and domineering upon the use of budgets as a control mechanism. Thus, how to use budget information would affect the subordinates towards the budgets.

As mentioned before, the hotels provide services which is difficult to measure or define. But as a service industry, it is important to satisfy the needs of the customers. Before satisfying the customers, it is important to satisfy the employees in order to provide good services. Thus, by tying rewards to performance, it is vital to measure their performance under fair and accurate way. It seems that it is preferable to use the budget information in a flexible manner under the ‘profit conscious’ style when evaluating the subordinates’ performance in the hotels.

In a conclusion, the hoteliers use the budgetary information as a basis to evaluate the subordinates’ performance. It is because it provides a quantitative measurement on the employees’ performance.

5.4 THE IMPORTANCE AND RELIABILITY OF BUDGETING

5.4.1 LITERATURE REVIEW—IMPORTANCE & RELIABILITY OF BUDGETING

‘Human beings make the budget and have to live with it. Budgets have a direct impact on human behavior. Budgets tell people what is expected of them and when it is due. They place limits on what may be purchased and how much may be spent.’

Siegel (1989)

It is clear that the budgets and humans have an interactive relationship.

When the budgets are less useful, the importance of the budget would be less.

However, there are many factors influence the efficiency and effectiveness of budgeting. The approach of budgeting would affect the figures of the final budget and the whole process. However, no matter which approaches that people used to make budgets, people cannot always be in an objective and unbiased manner during the whole budgetary process. Thus, budgetary slack would happen. On the other hand, how to use the budgetary information as a performance evaluation would

affect employees' perception towards the budgets and eventually affect their behaviour, i.e. performance. The details can be referred to the prior parts.

During second half year in 1997, the hoteliers suffered an unexpected downturn of tourism. A budget is a future plan which is made a year beforehand. It is therefore questionable about the reliability of the budget in this period. It is interesting to find out whether the reliability and the importance of budget loses during great uncertainty.

5.4.2 FINDINGS

A summary of findings is shown in Appendix C, Table D.

The Kowloon Shangri-La Hong Kong

The Assistant Controller said that the main purposes of budgeting are for planning and controlling. The reliability of the budgets is the same no matter what periods. He supported the statement by saying that the department heads have already put their effort to collect information for their budgets. So, the data is the most likely representing the reality. Even in periods of economic uncertainty, the importance of budgeting and forecasting cannot be understated.

They thought that budgeting and forecasting are always important. He said that once the budget is being approved, its target aims at meeting the figure. It can smoothen the management decision-making. He also added to say that the forecast is used to monitor the budget, too.

The Park Lane Hong Kong

The Financial Controller said that the reliability of the budgets is always the same. During the process, he and the department heads have used lots of operational

statistic and information to finish the budgets and forecasts. Thus, it is reliable no matter during good or bad times.

For them, the budgets and forecasts are always equally important. No matter what the situation is, budgets are used as planning and controlling. It definitely guides the management how much they can expense. However, during recession, a cost forecast is added to the cost budget. The cost forecast provides a more accurate and tighten expenditure control. Thus, they need the cost forecast in order to reduce the expenses as much as possible.

The Peninsula Hong Kong

The management uses the budget as a planning and controlling tool. The Financial Controller thought that the reliability of the budgets is always the same. During the budgeting process, he has obtained and analyzed the information about the economic environment, hotel industries as well as his hotel. Thus, he believed that whether the budgeted figures are wrong or right, he has studied his hotel thoroughly.

This can partly explained why he said that budgets are always important no matter how the economic changed. In addition, he saw the budgets as targets that drives

people to do better.

The Regent Hong Kong

The main purpose of budgets for the Regent is as a motivation tool. As the budget involves many predictions or assumptions towards the future, there is a direct relationship between the predictions and budgets. If the predictions fail (succeed) to show the real picture of the future, the budgets would be less (more) reliable. Since there is a great change in the environment, the budgeted figures are no longer serving the purpose for the future planning. Thus, the reliability of the budgets drops.

Therefore, the Assistant Financial Controller told us that during recession/fluctuation of the environment, the importance of budgeting would be dropped. On the other hand, forecasting becomes more important than the budgeting as it involves current predictions.

Renaissance Harbour View Hotel

The management viewed the budget as a motivation tool. The Financial Controller said that the budgets lose its power during uncertainty period. In the mean time, it

has lost its reliability. On the other hand, forecasting is relatively more reliable than budgeting in this period. It is easy to understand that during uncertainty, it's very difficult for the division head to look one year forward. So the actual results tend to be much deviated from the budgeted figures. As a result, the budgets lose its function of motivation. Thus, he supported the use of forecasts during fluctuation of environment.

Even though the reliability drops, he thought that the budgeting and forecasting is very important for managers to make decisions and for owners to prepare funds. As mentioned before, the management will not change their evaluation basis. Thus, they will use the budget and forecast information to evaluate the performance of the employees.

5.4.3 ANALYSIS

After the interviews, we found that the importance and reliability of budgeting and forecasting held on a cause-and-effect relationship. When its reliability reduces, then its importance also decreases, vice versa. Thus, both the interviewers of the Renaissance Harbour View Hotel and the Regent Hong Kong commented that during recession, the reliability of budget decreases and at the same time, the importance of budgeting and forecasting decreases. The other three interviewees, however, just said that the importance and reliability are always equally the same no matter during stable or volatile periods.

Budget is based on many predictions/assumptions towards the future. Thus, this seems that when the real environment is highly volatile, there will be great budget variances. However, not all hotels' personnel interviewed commented that the reliability and importance of budgets become less during uncertainty. This may be the result of the different purposes of the budgets and forecasts for each hotel. If the situation fluctuates greatly, it makes them impossible to meet the budget target since it is unrealistic and unachievable. If so, how can the employer use it as a motivation tool? Therefore, the budgets and forecasts are less important if the budgets cannot be used to motivate the employees.

However, the other three hotels use the budgets as a planning and controlling purpose rather than only for motivating the employees. Although the budgets cannot serve the purpose of motivation, they can still be used to serve the purpose of planning and controlling. Thus, the budgets and forecasts are still important and reliable even with great fluctuation.

Hence, this seems that the major functions of the budgets concerned by the hoteliers would affect the reliability and importance of the budgets during uncertainty period.

CONCLUSION

In view of the findings and comments given in the previous section, the following conclusions are drawn.

Firstly, it appears that most of the hoteliers choose to use the participative budgeting approach. Their aims of using this approach are to gain their commitment, motivation, responsibility, cohesiveness, thorough understanding about their divisions and gain some flexibility. However, it is not conclusive to say that which approach is the best. The budgetary approach should match the best technique of the hotel with its environment. Such as the factors of organization culture, personality of subordinates and leadership style which will affect the effectiveness of participative approach.

Secondly, it appears that some of the hotels are facing the problem of budgetary slack. The results of the study suggest that even though the participative approach may allow subordinates having a greater opportunity to set up their favourable budget targets, it cannot be asserted that there is a positive relationship between participation and building budgetary slack.

Thirdly, the hoteliers would probably use the budgetary information as a basis to evaluate the subordinates' performance. Some of the hotels may just concern either meeting the forecast or the budget, not concern any other factors which may affect the performance of the subordinates. However, most of the hotels will concern the

changing environment and adjust their evaluation style in order to have a fair judgement.

Finally, the different functions of the budgets viewed by different hoteliers are likely to affect the reliability and the importance of the budgets during uncertainty period. When the hotels use it as a motivation tool, the uncertainty will greatly reduce the reliability and hence the importance of the budgets since the unrealistic goals cannot motivate employees at all. On the other hand, when the hotels use it as a planning and controlling tool, the uncertainty may not affect the reliability and the importance of the budgets since it has already served the purpose for planning.

In conclusion, the hoteliers seem to have some consideration when having a budgetary system. Some of the recommendations are made for consideration in order to improve the system.

RECOMMENDATIONS

Using the participative budgeting approach

Although it is unable to conclude which approach is better than the others, we recommend the hoteliers to use the participative budgeting with the considerations of the characteristics of his hotel environment. The hotels need an extraordinary cooperation than other industries. The participative budgeting fosters communication among departments and therefore increases the cooperation and coordination of the hotels.

However, the hoteliers should concern the problem of pseudo-participation as it can be expected to create serious morale and motivation problems. Indeed, if for some reason a firm is unable to use true participation effectively, it would probably be much wiser to follow authoritarian budget practices and honestly admit it than to engage in the pretense of pseudo-participation.

Thus, the hotels should consider the limitations of the factors, such as organization culture, the personality of the subordinates and leadership style.

Using the budgetary information

As the hospitality services are intangible, it is difficult to have a quantitative criterion to measure the performance. We recommend using the budgetary information to evaluate the employees' performance in a flexible manner.

Satisfaction of the employees' needs

In order to motivate the employees to meet the budget, it is important to realize their wants to build up a good reward system that tie the rewards to the performance. This helps them to meet the budget targets or even to improve the overall performance. In addition, the hotels can use budgeting and bonus techniques to overcome the problem of slack budgeting. One such approach consists of paying higher rewards when budgets are set high and achieved, and lower rewards when budgets are either set high but not met or set low and achieved.

Accounting information system

In order to facilitate the budget-setting and make adjustment, it is possible to develop the accounting information system to provide the information available for the users during the whole budgetary process. This can foster the efficiency and effectiveness of budgeting. In addition, this can increase the reliability of budgeting.

Evaluation of performance

With the support of Hopwood (1972) study and our findings, the budgetary information is useful as an unambiguous evaluation basis. After considering the effects of the different styles of evaluation, it is recommended that the hoteliers are better to use 'profit conscious' style. In the hotel industry, if there are poor relationships between employees, no matter with superiors or colleagues, then how the hotels can provide a good or standard service to satisfy the needs of customers.

BIBLIOGRAPHY

1. Adams, Debra, *Management Accounting for the Hospitality Industry*, Cassell, 1997
 2. Belkaoui, Ahmed, *Conceptual Foundations of Management Accounting*, Addison-Wesley Publishing Co., 1980
 3. Belkaoui, Ahmed, *Organizational and Budgetary Slack*, Quorum Books, Westport, Connecticut London, 1994
 4. Caplan, Edwin H., *Management Accounting and Behavioral Science*, Addison-Wesley Publishing Co., 1971
 5. Carmouche, Rita and Kelly, Nancy, *Behavioural Studies in Hospitality Management*, Champman & Hall, 1995
 6. Chandra, Gyan, "The Bahavioral Aspects of Budgeting", *Handbook of Budgeting 3rd Edition*, John Wiley & Sons, Inc., 1993
 7. Coltman, Michael M, *Hospitality Management Accounting 5th Edition*, Van Nostrand Reinhold, 1994
 8. Dunk, Alan, *The Effect of Budget Emphasis and Information Asymmetry on the Relation between Budgetary Participation and Slack*, A Journal of the Accounting Review Vol. 98, No. 2 April 1993, pp. 400-410
 9. Emmanuel, Clive, Otley, David, and Merchant, Kenneth, *Readings in Accounting for Management Control*, Chapman & Hall, 1992
 10. Gray, William S., *Hospitality Accounting*, Prentice-Hall, Inc., A Simon & Schuster Co., 1996
 11. Harries, Peter, *Profit Planning*, Oxford; Boston: Butterworth-Heinemann, 1992
 12. Hopwood, A.G., *Accounting and Human Behavior*, Prentice-Hall, Inc., Englewood Cliffs, NJ, 1976
-

13. *Hotel Occupancy Report*, 1996, 1997, Hong Kong Tourists Association
 14. Kotas, Richard and Coulan, Michael, *Hospitality Accounting*, International Thomson Business Press
 15. Libby, Theresa, *The Influence of Voice and Explanation on Performance in Participative Budgeting Setting*, A Journal of Accounting Organization and Society 24 , pp.125-137, Pergamon, 1999
 16. Mullius, Laurie J, *Managing People in the Hospitality Industry 3rd Edition*, Harlow, Longman, 1998
 17. Nebel III, Eddystone C., *Managing Hotels Effectively*, Van Nostrand Reinhold, NY, 1991
 18. Nouri H. and Parker, R.J., *The Relationship between Budget Participation and Job Performance: The Roles of Budget Adequacy and Organization Commitment*, A Journal of Accountancy, Organizations and Society Vol. 23, No. 516, pp. 467-483, Pergamon, 1998
 19. Olsen, Michael D., Teare, Richare and Gummrrsson, Evert, *Service Quality in Hospitality Organizations*, London, New York, Cassell, 1996
 20. Siegel, Gray, *Behavioral Accounting*, South-Western Pub. Co.,1989
 21. *Visitors Arrival Statistics*, 1996, 19967, Hong Kong Tourists Association
-

Dear Sir/Madam,

Request For An Interview - Budgetary Process and Control

We are final year Accountancy students at Lingnan College and are conducting a research project as a requirement for graduation. Our project is concerned with the importance of budgeting and forecasting in hotel industry during recession.

As your organization is one of the leaders in the hotel industry, we are interested in hearing your views on the issue of budgetary process and control. Your assistance and support are essential for the completion of our project.

The general areas of our interest include:

1. Understanding your organizational structure,
2. The budgeting process for your hotel,
3. The key factors considered in planning the budget, and
4. The factors limiting the effectiveness of the budget.

We would certainly appreciate the opportunity to meet with you and discuss the above issue. We are hopeful that you will provide assistance in arrangement this meeting. Our estimate is that an interview will require approximately one half-hour. Of course, any information discussed will be kept strictly confidential.

We should be most grateful if you would kindly consider our request and grant us an interview at your earlier convenience. To confirm an interview, please contact me by mail/ mobile phone.

Thank you very much for your attention.

Yours faithfully,

LEE, Angel

Questions for Interview

I) Background Information:

- 1) Which groups are your targeted customers? (both functions and nationality). Which group is the most being affected by the recession? How has the recession affected your occupancy rate?
- 2) In general, how has your hotel responded to the pressure on profits brought about by the recession?
- 3) Does the Accounts Department initiate and control the budgeting process or does it responds to other departments?
- 4) Explain the budgetary process. And who will be involved in the budget setting?

II) Other Information:

- 5) What are the criteria you will concern when setting the goals? And which one you will concern the most during the recession?
 - 6) Is your hotel using a participative approach or a non-participative approach during budgeting? Could you comment on why you prefer the chosen approach? Are there any negative aspects?
 - 7) Do you believe that there is a tendency for the managers to create budgetary slack when setting their budgets? And how would you advise them to avoid this problem?
 - 8) Are there any differences on motivating your employees compared to the past economic growth?
 - 9) What is your basis for the evaluation of the managers' and employees' performance? I.e. 'budget constrained' style, 'profit conscious' style or 'non-accounting' style. By comparing them, which one do you believe is most helpful?
-

- 10) After discovering the variances or deviation, what actions you would probably like to take?

 - 11) Do you think that budgets made in the current recessionary climate are equally reliable when compared to budgets made during Hong Kong's economic growth period?

 - 12) Could you comment on the importance of budgeting during recession? Is it possible to replace the functions of budgeting by alternative approaches?

 - 13) Which functions of the budgets that you aim to manage your organization?
-

SUMMARY OF FINDINGS

Table A A Summary of Findings on Budgetary Approach

	Budgetary Approach	Reasons
The Kowloon Shangri-La Hong Kong	Participative	i) Gaining commitment ii) understanding the history of department
The Park Lane Hong Kong	Participative	i) gaining cooperation
The Peninsula Hong Kong	Non-Participative	i) obtaining operational efficiency
The Regent Hong Kong	Participative	i) emphasizing responsibility ii) increasing managers' skills iii) bettering management plan
The Renaissance Harbour View Hotel	Participative	i) gaining commitment

Table B A Summary of Findings on Budgetary Slack

	Any budgetary slack	Remarks
The Kowloon Shangri-La Hong Kong	Yes	
The Park Lane Hong Kong	None	Employees tend to estimate or predict wrong figures.
The Peninsula Hong Kong	None	
The Regent Hong Kong	Yes	
The Renaissance Harbour View Hotel	Yes	

Table C A Summary of Findings on Style of Evaluation

	Style of evaluation	Main emphasis on evaluation
The Kowloon Shangri-La Hong Kong	Budget Constrained Style	Emphasizing meeting the budget targets
The Park Lane Hong Kong	Profit Conscious Style	Concerning the flow of the business
The Peninsula Hong Kong	Profit Conscious Style	Concerning the quality of service
The Regent Hong Kong	Budget Constrained Style	Using the budget variances as the main source for evaluating employees' performance
The Renaissance Harbour View Hotel	Budget Constrained Style	Using budgets as a motivation tool – so it is a easier way to evaluate the employees' performance

Table D A Summary of Findings on Reliability and Importance of Budgeting and Forecasting

	Main purpose of budgeting	Reliability of budgeting	Importance of budgeting
The Kowloon Shangri-La Hong Kong	Planning and Controlling	No different at any time	Equally important at any time
The Park Lane Hong Kong	Planning and Controlling	No different at any time	Equally important at any time
The Peninsula Hong Kong	Planning and Controlling	No different at any time	Equally important at any time
The Regent Hong Kong	Motivation	Less reliable during great fluctuation	Less important during great uncertainty
The Renaissance Harbour View Hotel	Motivation	Reliability is low and budgets lose its power during recession	Less important during great fluctuation of environment