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Budgeting and Budgetary Control System affecting Pakistan SMEs Performance

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Waqas Mehmood

Abstract Organizations face intense competition in the commercial sector, both in developed and developing nations. Businesses that intend to remain competitive must encourage the desire to understand the function of budgeting and how it affects their financial success. Most research has focused on how budgetary implementation affects organisational performance in both the commercial and public sectors neglecting SMEs. The current study is conducted to study the effect of budgeting and budgetary control systems on Pakistan SMEs performance circulating an adopted questionnaire physically, considering 210 respondents as the sample size using purposive sampling technique, as a result of which 187 responses were received, with a valid response rate of 89.04%. The proposed investigation comprises descriptive statistics, correlation analysis, convergent & discriminant validity, and regression analysis. The current study's findings revealed a significant positive impact of both budgeting and budgetary control systems on SMEs performance. The study recommends senior managers be careful while preparing a budgetary plan and also implement measures to address existing budgetary control system issues. A significant limitation of this study is to consider only non-financial performance as a SMEs performance measuring tool neglecting financial performance, which potential researchers can eliminate.

Keywords Budgeting, SMEs Performance, Budgetary control system, Budgeting issues.

1 Introduction

Small and medium enterprises (SMEs), viewing at the macro-economic level no matter how a country's economic level is going on, play an essential role

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in regional and employment development. One of the significant SMEs advantages is that they are assumed to be effortlessly familiar with changes, be ready to fulfill customers' demands and have market-based production ability while undertaking different tasks into action. Besides paving the way to achieve a competitive edge in the market in the current scenario, both technical and socio-economic developments guarantee market enlargement [Mohiuddin et al \(2013\)](#). SMEs make up 80% of the non-agricultural labor force and 95% of businesses in Pakistan, making them an essential component of the country's economy [Zafar and Mustafa \(2017\)](#). They support value addition, employment, exports, and GDP growth. Pakistan SMEs have grown remarkably in the IT, FinTech, E-commerce, and freelance services sectors [Rehman et al \(2023\)](#) despite obstacles in the fiscal, monetary, and regulatory domains [Arshad et al \(2020\)](#). Both established and developing industries have also shown a tremendous growth potential, such as knowledge-based businesses and technological textiles in the recent years.

Enterprises should be ready for proper planning and organizing to compete and maintain their market existence; for this, they must emphasize productivity, effective budgeting, and adequate control plus implementation. Budgeting is the management's projection of future courses of action in the form of financial statements. Information from management accounting can be used by management to create plans. Implementing internal controls is crucial for the organization to fulfil its goals. The budgetary control system is a vital element in the conduct of internal controls. In emerging nations like Pakistan, there has been a lot of focus on strengthening budgetary planning and management, as well as how they relate to one another [Bakhsh et al \(2019\)](#); [Zada et al \(2021\)](#). Making a precise forecast of the financial outcomes that are anticipated for a given period is the process of budgeting. A budget is a set amount of money designated for a specific purpose, a list of anticipated expenses, and suggestions for covering them. By demanding executives to assume in what way circumstances possibly will vary and what measures should be taken at the moment, as well as by persuading administrators to think about challenges before they happen, it serves to aid in the actual operations planning. Furthermore, it aids in the coordination of organizational activities by forcing managers to consider how their functions relate to those of other departments to manage resources; inter-connect plans to various accountable center executives; encourage managers to work toward achieving budget goals; to assess manager's performance, and to provide accountability and visibility into the concern's performance.

Firms typically use budget control as their core corporate internal control strategy because it offers a platform to management for the effective and efficient allocation of resources. Budgetary control proper execution is a vital guarantee for the efficient execution of the budget in the business. Budgetary control allows the managerial team to set plans by implementing them and monitoring activities to determine whether they comply with the plan [Otley and Pollanen \(2000\)](#). Budgetary control is the process of creating a spending plan and comparing actual spending to that plan regularly to see if either one needs to be adjusted to keep on track and is a requirement for organizations to manage their spending and achieve desired financial objectives. More signif-

icant expansion opportunities and the ability to increase management control are made possible by budgetary control, which only works successfully in highly managed businesses [Reed \(2022\)](#). The private and public sectors, along with the individuals from all walks of life who are intended to ensure they live within their means, all rely significantly on budgetary control to manage their outlay doings [Kimani \(2014\)](#). In this regard, a study is needed to be conduct to learn more about the budgetary procedures of a Pakistani business. Most research has focused on how budgetary implementation affects organisational performance in both the commercial and public sectors [Mauro et al \(2020\)](#) but this research examined the relationship between budgetary implementation tools and organizational performance particularly in the case of SMEs that has added value by filling the gap with respect to this particular business. Furthermore, the studies are conducted in other countries like Somalia [Ali et al \(2023\)](#), Kenya [Mbogo et al \(2021\)](#), Nigeria [Onyebuchi \(2022\)](#) and other countries. This signify a need of a research in the context of Pakistan. Therefore, by determining the effect of budgetary control methods on organizational performance at the SMEs in Pakistan, this study aimed to fill the gap. For this purpose, this study is based on budgetary control theory [Robinson and Last \(2009\)](#).

Every business, no matter how large or small, uses the budgeting tool, puts it into practice, compares what happened to what was planned, and takes action to prevent similar problems from happening again through an effective controlling system. The budgeting process is an important activity in the life of any organization, and it should be treated with the respect it deserves because it governs the company's actions. Budgets should be prepared using good planning, estimation, preparation, and resource analysis. The budget policy must be open and inclusive, and all company employees must know and understand the organization's budgeting policies for which the employees at all levels are involved in the creation of budgetary control system but the main issue is that only upper-level employees are engaged in the formulation of budget policies, which has a negative impact on performance. Therefore, the main objective of the examination is to find the causal effect of budgeting and budgetary control systems on SMEs performance. Furthermore, the study is extended to highlight the main issues relating to budgetary control systems and budgeting in firms.

Based on these objectives, following research questions are needed to address.

1. Is there any causal effect of budgeting and budgetary control systems on SMEs performance?
2. Is there any causal effect of budgeting and budgetary control systems on SMEs performance?
3. What are the main issues relating to budgetary control systems and budgeting in firms?

2 Literature Review

Budgeting control is said to improve the performance of an organization through the provision of a structural approach to financial control. The literature reveals that budgetary control systems enhance performance in several ways. In a study by [Lutwama \(2017\)](#) on how to gauge a nonprofit organization's performance, it

was discovered that budgetary control was one of the critical strategies for improving efficiency in nonprofit-making companies. The study's findings showed that strong budgetary management enhances local government performance. Similarly in another study, [Nair and Kaab \(2017\)](#) proved that the organization's culture influences control, performance, and people. All are the three key factors that affect budget management and budgetary control. [Paul and Renmans \(2018\)](#) research also noted that when department managers have higher budgetary motivation and a more optimistic outlook toward their departments' finances, the budgeting efficiency tends to be higher. A budget control system is a valuable tool for minimizing accounting irregularities and significantly affects employee motivation, which results in service charge cost reductions. No budgetary control system is effective, according to [Derks and Romijn \(2019\)](#), unless it allows for the integration of financial accounting, budgeting, and managerial accounting. Putting forth the arguments, the scholars contend that they facilitate improved resource allocation this is because resources can be directed towards the right projects and departments that will support the achievement of the strategic goals and plans. This alignment is important so that the organization is on track and goals are met in the long-run.

As per [Shefren et al \(2021\)](#), research on company budget planning, control, and performance evaluation looked at the budgetary control and budget planning methods used by Bahraini firms. According to the study's findings, most businesses create variable and fixed budgets and maintain strict processes for controlling their spending. The argument is supported by [Panyako and Miroga \(2024\)](#), who contended that budgetary control systems assists in performance evaluation and reporting. Through establishing financial goals and comparing the actual financial performance against these goals, an organization can notice deviations and act on them immediately leading to avoid risks and enhancing efficiency of the operations (performance). According to [Bukh and Svanholt \(2020\)](#) research, a budgetary control system cannot be effective in controlling, negating, motivating and planning without the support of organizational members. Likewise, according to [Gärtner and Tran \(2021\)](#), budget control systems and standard costing continue to be the foundation of many firms' management control systems. They argued that budgetary control is comprehensive, practical, and the most commonly used standard for controlling and planning. The arguments are supported by [Pattinaja et al \(2023\)](#); [Baya \(2023\)](#), who contended that budgetary control systems has a positive influence on the decision making process of managers in research as the preparation of detailed financial reports and forecasts is an important element of these systems, which gives the managers important information about the organization's financial situation and helps them to make the right decision to enhance the strategic planning and management of operations leading to an adaptable environment for organizations to boost performance.

Similarly, according to research on budgetary control systems by [Greenfield et al \(2022\)](#), the majority of corporate firms use budgetary control as their primary integrative control approach. The budget is assumed to be a financial representation of an organization's business plan and a tool for monitoring and controlling the business plan's many details. Likewise, [Kim et al \(2022\)](#) investi-

gated the relationship between the effects of budgetary control on performance using a sample of large US cities' financial bonds. They discovered that the bond rating is significantly and positively related to the adequate level of budgetary control. Furthermore, it is important to note that the use of budgetary control systems encourages cost consciousness and financial responsibility within the organization. Through engaging different departments in the budgeting process, organizations can ensure that everyone feels responsible for the money spent and thus improves on the prudent use of funds [Bakhsh et al \(2019\)](#); [Zada et al \(2021\)](#). In sum, the literature has highlighted that budgetary control systems positively affect the organizational performance largely because of better resource utilization, performance evaluation, decision making, and financial accountability.

H1: Budgetary control system will have a positive effect on organizational performance.

Budgeting is one of the most important management tools, which impacts organizational performance in several ways. Research findings have shown that there is a relationship between the use of budget and the performance of organizations. Research by [Agbenyo et al \(2018\)](#) about budgeting and its effects on the Ghana non-bank financial institution's financial performance showed a link between budgeting and business performance. The study also showed that businesses used established budgeting procedures more frequently and that making financial arrangements management has a statistically reasonably favourable link with business performance. [Cheboi \(2019\)](#) found vehicle concerns that implemented budgetary planning techniques had favourable performance ratios, and those that did not exercise those procedures had unfavorable performance ratios when evaluating the effects of budgetary planning tools on the financial performance of registered public service vehicle companies in Kenya. The study also found that few people in the field were aware of these strategies, and those who were did not apply them well. The arguments are also supported by [Ivanchenkova et al \(2021\)](#) and [Olaniyan and Efuntade \(2020\)](#), who contended that budgeting improves financial control and resource management allowing the organization to distribute its resources properly and optimally. Which in turn helps in avoiding wastage of resources, and hence, improving efficiency in achievement of organizational goals (high performance).

Using a cross-sectional research design, [Mwaguni et al \(2020\)](#) found that budgetary participation and budget planning have a significant positive impact on the effectiveness of revenue collection for water service providers, whilst budget control procedures and budgeting approaches do not have any considerable consequence on profits collection in the industry under study. A study on the impact of budgets on the manufacturing firm's financial performance in Nigeria County was undertaken by [Onyebuchi \(2022\)](#). Both primary and secondary data were employed in the investigation. The research showed that management and using budgets impacted financial performance as assessed by return on assets contending that enterprises having qualified employees for budget development has a higher chance of profitability. The arguments are supported by [Alam and Alam \(2022\)](#) and [Tirkashev and Eshtemirov \(2022\)](#), who contended that bud-

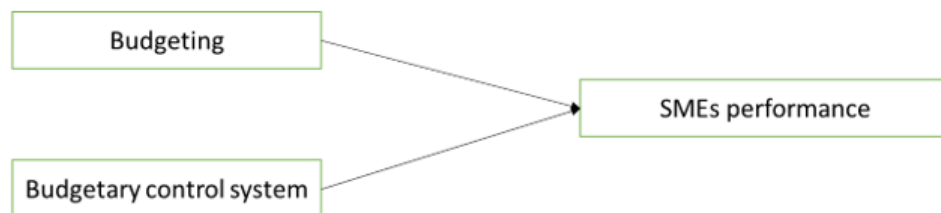
getting helps in goal setting and control, as it presents a plan of operations for an organization and assists the managers in assessing the levels of achievement of planned goals. This fosters responsibility and disclosure of information, ensuring that the personal and corporate objectives are met. Resultant of which, it improves communication and cooperation within the firm; this leads to better organization of departments and improved decision-making.

H2: Budgeting will have a positive effect on organizational performance.

2.1 Theoretical review

Budgetary control theory holds that an effective budgetary control system must address the efficiency and efficacy of the organizational spending [Robinson and Last \(2009\)](#). Budget, as per the views of [Hillen and Lavarda \(2019\)](#) can be used as an indicator of how well the recent management is doing in performing different tasks within the concern. It is a verdict on their suitability to manage the company and the country's riches. Therefore, the business must comprehend its budgeting system and priorities pressing issues that call for attention to its control mechanisms. The company must identify trends in organizational spending and performance to understand the relationship between organizational performance and the budgeting system [Pyhrr \(1973\)](#).

Figure 1
Study model



3 Research Methodology

The main target of the examination is to find out the causal effect of budgeting and budgetary control systems (both are independent variables) on organizational performance (dependent variable). The study is further extended to highlight the issues related to budgetary control systems and budgeting. The current quantitative study uses deductive research design. An adopted questionnaire from the study of [Nair and Kaab \(2017\)](#) comprising five items for budgeting and budgetary control system while four for SMEs performance was used in the current study using purposive sampling from Lahore, Sialkot, Daska waziraabad Gujarat and Gujranwala considering the top and middle-level managers working in Pakistan SMEs in accounting and auditing departments as respondents. To highlight the issues related to budgetary control systems and budgeting, five open-ended questions were asked concerning inadequate information, organizational strategies, undetermined responsibilities, senior manage-

ment negligence and lack of financial expertise from the study of [Nair and Kaab \(2017\)](#). The unit of analysis in this study is SMEs; therefore, for data collection, seventy companies were chosen based on a 5:1 chart recommendation for sample size and three questionnaires were distributed to each firm for data collection aligned with [Green \(1991\)](#). The methodology is also used by [Hassan \(2023\)](#). Ethical considerations like voluntary participation, declaring research purpose, and ensuring confidentiality were ensured before data collection. The current research is cross-sectional and conducted in a non-contrived study setting. Two hundred ten questionnaires were distributed, out of which 187 were returned, with a valid response rate of 89.04 percent. The data analysis tests used in the current study are descriptive statistics, normality analysis using Skewness and Kurtosis, correlation analysis, and, finally, multiple linear regression to examine the causal relationship of all understudied explanatory variables on the dependent variable. Besides these analyses, classical assumptions like heteroskedastic, autocorrelation and absence of multicollinearity have been assessed along with convergent and discriminant validity. The research was performed in a non-contrived work setting and, in other terms, a natural environment that reflects the real-world context of the outcome with zero researcher interference.

4 Data Analysis

4.1 Normality analysis and descriptive statistics

Concise helpful coefficients, mainly central tendency measures, known as descriptive statistics, are utilized to sum up whole specific data set, which may be a subset of a population or a depiction of the entire population in Table 1 using mean and standard derivation values. The term “standard deviation” indicates measuring the data point scattering as of simple average value. Low STD entails that data is clustered across simple average values, while high STD shows that data has dispersion.

Table 1
Normality analysis and descriptive Statistics

Variables	Average	Standard deviation	Skewness	Kurtosis
Budgeting	4.04	0.69	-1.41	2.78
Budgetary control system	4.01	0.68	-1.27	1.95
SMEs performance	3.99	0.65	-1.82	5.04

In Table 1, the average values are 4.04, 4.01 and 3.99 for budgeting, budgetary control system and SMEs performance, along with standard deviation of 0.69, 0.68 and 0.65, respectively. The skewness and Kurtosis test is employed in the current study to examine the data set normality, depicted in Table 1. There are two different schools of thought for identifying whether data is normal or not based on skewness and Kurtosis. According to one school of thought, the threshold values are between plus and minus two for both. At the same time, another school of thought urges researchers to use a threshold or rule of thumb of plus-minus ten. As in our case, the recommendations of the second school of thought are fulfilled, and since skewness and Kurtosis statistic values are between plus and minus ten [Griffin and Steinbrecher \(2013\)](#), therefore, we can

reliably confirm that normality is assured for all variables.

4.2 Convergent and discriminant validity

For the variables to ensure convergent validity, composite reliability, Cronbach alpha, and rho-A should be 0.70 or above, while average variance extracted (AVE) should be 0.5 or above [Hair Jr et al \(2014\)](#).

Table 2
Convergent validity

Variables	Cronbach alpha	Rho.A	CR	AVE
Budgetary control system	0.810	0.820	0.870	0.570
Budgeting	0.790	0.820	0.850	0.530
SMEs performance	0.700	0.710	0.800	0.510

The results in Table 2 confirm the convergent validity for all variables. While for the confirmation of discriminant validity using Fornell-Larcker criteria, the AVE square root should be higher than all correlations of a specific variable with all other considered variables in the study.

Table 3
Discriminant validity (Frowner-Larker criteria)

Variables	Budgetary control system	Budgeting	SMEs performance
Budgetary control system	0.757		
Budgeting	0.486	0.731	
SMEs performance	0.618	0.545	0.713

The results are depicted in Table 3, and AVE square root values in bold confirm the discriminant validity.

4.3 Correlation analysis

A correlation is an association of two variables classifying as weak in a case of less than .30, moderate if it ranges from 0.31-0.7 and above value shows a high and perfect correlation [Schober et al \(2018\)](#).

Table 4
Correlation matrix

	SMEs performance	Budgeting	Budgetary control system
SMEs performance	1		
Budgeting	.468**	1	
Budgetary control system	.531**	.467**	1

** p<0.05 (Two-tailed)

In the current study, a positive and significant correlation has been found at 0.05 level between budgetary control systems and budgeting with SMEs performance.

4.4 Regression analysis

Robust regression is applied to the data set to avoid the heteroskedasticity issue by employing multiple linear regression because of the non-linearity issue in variables. The VIF value of all variables is less than five, which shows no multicollinearity in the data set. R squared value is 0.344 showing 34.4 percent variation in the dependent variable, namely SMEs performance, if all the independent variables are taken collectively, namely budgetary control system and budgeting. The probability > F is less than five percent shows that model is statistically fit. Furthermore, Skewness/Kurtosis tests for residual normality (adj chi2(2) is 51.74*** confirm the normality of residuals, while the Durbin statistic for both models is less than two but close to two shows no autocorrelation.

Table 5
Regression coefficients

Path	Coefficients	VIF	Tolerance
Budgetary control system ->Profitability	0.417*** -0.0973	1.280	0.780
Budgeting ->Profitability	0.277*** -0.0737	1.280	0.780
Constant	1.232*** -0.350		
Observations	0.417*** 187		
R-squared	0.344		
Root MSE	0.55428		
F(2, 184)	35.57		
Prob>F	0.000		
Skewness/Kurtosis tests for residual normality (adj chi2(2))	51.74***		
Durbin Watson	1.870		

Robust standard errors in parentheses
 *** p<0.01, ** p<0.05, * p<0.1

5 Discussion on Results

The first objective of the examination was to find the causal effect of budgetary control system on SMEs performance. The regression table reports that the beta coefficients for the understudied causal relationship is 0.417 showing the positive relationship. Furthermore, the result is highly significant with P value < 0.001. the obtained results of budgetary control system-profitability are consistent with the findings of [Pattinaja et al \(2023\)](#); [Baya \(2023\)](#), who contended that budgetary control systems has a positive influence on the decision making process of managers in research owing to the preparation of detailed financial reports, which gives the managers important information about the organization's financial situation and helps them to make the right decision ultimately leading to effective decision-making process about the strategic planning and management of operations for organizations to succeed.

Furthermore, the second objective of the examination was to find the causal effect of budgeting on SMEs performance. The regression table reports that the beta coefficients for the understudied causal relationship is 0.277 showing the positive relationship. Furthermore, the result is highly significant with P value < 0.001. the obtained results of budgetary control system-profitability are consistent with the findings of [Alam and Alam \(2022\)](#); [Tirkashev and Eshtemirov](#)

(2022), who contended that budgeting helps in goal setting and control, as it presents a plan of operations for an organization and assists the managers in assessing the levels of achievement of planned goals.

Overall, both budgetary control system and budgeting are positive and highly significant, which shows the acceptance of both developed hypotheses. This indicates that the budgeting system and budgetary control system of Pakistan SMEs can increase profitability. Furthermore, the results are also consistent with the budgetary control theory which states that the formulation of sound budgetary policies and the implementation of strict control measures enhances the achievement of organisational goals and objectives. Thus, the study supports the theoretical framework and highlights the need for strong budgetary control systems to enhance resource management, financial activities, and organizational success.

The third objective of study was to highlight the main issues relating to budgetary control systems and budgeting in firms. Table 6 presents the prevailing issues in SMEs regarding properly implementing budgeting and budgetary control systems. 97 (51.9 %) of the respondents highlighted senior management negligence as a significant factor/issue for not properly implementing budgeting and budgetary control systems following organizational strategies and undetermined responsibilities.

5.1 Economic implications

The positive correlations established between budgetary control systems and budgeting with the SMEs' performance have significant economic consequences. As the beta coefficient for the budgetary control system increases, it indicates that the implementation of the system affects the performance of SMEs to a relatively greater extent. This clearly points to the need for putting in place effective measures of checking the use of available resources and the overall financial management. Likewise, the correlation between budgeting and SME performance means that proper planning and management of budgets are beneficial for organizational success. Nevertheless, factors like senior management negligence demonstrate that organizational challenges should be dealt with to enhance the application of budgeting and budgetary control systems. Solving these issues can positively impact the general economic performance and productivity within the SME sector to achieve sustainable growth and profitability.

5.2 Academic implications

The results also have some important theoretical implications for exploring the relationships between BC systems, budgeting, and SME performance. These positive associations provide directions for future research on how these factors may impact organisations in the future. In terms of scholarly research, it calls for a deeper understanding of the finer details that define the contingency factors in the context of budgetary control systems and budgeting practices within SMEs. Also, problems such as senior management negligence show that organizational behavior and management theories are still useful in explaining the conditions that hamper implementation. It can be useful for researchers to

look at these issues in more depth so as to establish theoretical models for use in the management of SMEs budgeting. In addition, academic literature could concentrate on finding out the lessons and the ways of avoiding these challenges, which would expand the knowledge of how SMEs can improve their efficiency of financial management and increase their competitiveness.

5.3 Policy implications

The positive associations of budgetary control systems, budgeting and SME performance suggest the following policy implications. Officials must appreciate the importance of budgetary practices in the development of SMEs and their competitiveness. Attention should be paid to raising awareness and identifying the necessary support measures for SMEs to implement efficient budgetary control and budgeting. Issues such as senior management negligence can only be solved through policy solutions that seek to promote increased accountability and proper financial management within SMEs. In this regard, it is recommended that policymakers should encourage or support SMEs by giving incentives or resources to help them overcome the challenges of implementing the budget. Thus, the improvement of the support system in the sphere of financial management will help policymakers enhance the conditions for SMEs' sustainable growth, job creation, and innovation, which, in turn, will ensure the sector's maximum contribution to the overall economic growth.

6 Conclusion

Budgeting is crucial because it defines how the firm can achieve its financial and other objectives. Thus, the current study was done to look into Pakistan organizations' budgeting and budgetary control systems (BCS). According to the analysis of the study's data, most firms have budgetary control systems in place, but they might need some improvement. Most respondents concurred that there is a significant relationship between organizational effectiveness and financial control. Most of the respondents eventually concluded that there are certain obstacles to implementing BCS properly in their organizations. The results showed that senior management is the biggest obstacle to BCS implementation. As a result, senior management plays a significant role in BCS implementation, and management-related issues must be resolved if organizational objectives are to be met.

The study suggests that management should implement measures to address budgetary control system issues, such as improving staff understanding of budgetary control procedures, their behaviour, and institutional dynamics, strengthening financial integration with performance management, and quarterly financial plan revision to reallocate resources frequently. Governments should also define yearly goals for each performance indicator in their budgetary control system so that civil servants, business owners, and other employees know the plans that must be met. Both employees and business owners should put forth a lot of effort to meet these goals. A significant limitation of this study is to consider only non-financial performance as a performance tool neglecting financial performance. Future researchers can use a financial perceptiveness to overcome

this limitation. Other elements that may have a direct or indirect influence on organizational productivity, like budgetary effectiveness techniques, might also be investigated further. In this study, we used a cross-sectional approach, which means that the investigation would take place once a period. However, by comparing earlier studies with the current study, future researchers may employ the longitudinal method to get superior findings. It will be more beneficial for researchers and companies to make better selections to attain strategic goals. The study suggests more investigation into organizational performance and budget planning, as well as the relation between budget execution and organizational performance.

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