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AN EMPIRICAL ANALYSIS ON THE EFFECTS OF BUDGET CONTROLS AND RISK MONITORING ON FINANCIAL PERFORMANCE IN ALBANIA

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Abstract

About 20% of new businesses fail within the first year of their establishment. The main cause for most business failures is poor planning, where the budget is the main planning tool. In budgeting, the focus is not only on budget preparation but most importantly having a follow-up budgeting operation and acting on known data. Budgets have an important role in the organizational management because the multiple purposes that are used. What is clear from many authors is that budgets are an integral part of most organizations and support key management functions of planning, management, control and decision making. Also, the financial crisis shed light on the numerous weaknesses and narrowings of the financial system that resulted in the collapse of the global financial system. Therefore, due to its importance and complexity, financial stability can be affected by excessive risk taking, inadequate risk measures and mitigation measures, and the lack of sound governance policies. The purpose of this study is to examine whether budget planning, budget control and risk oversight affect the financial performance of businesses. A descriptive research model was used in this study. According to INSTAT, Albania currently has about 166 thousand active businesses. Due to the very large number of enterprises and businesses, the study focused on the districts of Tirana and Durres, where the target population was 350 businesses. The study concluded that budget planning and risk oversight significantly affect financial performance. Better planning using budgets can help company leaders improve the financial health of their businesses, potentially reducing business failures and job losses. Financially strong and healthy businesses can create jobs and improve the economic health of local communities.

Keywords: Albania, Budget, Control, Financial Performance, Risk, Stability

INTRODUCTION

For many years, budgets have been used throughout private and public organizations to set goals and control and regulate the behavior of managers. Depending on whether the organization is operating in the private or public sector, the budget is set in order to meet certain requirements. Taking into account the performance requirements for the budget, the private sector is profit-oriented, while the achievements of the public sector budget are evaluated based on the services provided by the organization. However, given that the paper has its main focus on the private sector, it can be noted that private organizations recognize the main challenges in the way their budgets have been used in recent years. The financial crisis of 2008, as well as the previous euro crisis, greatly affected the financial and economic situation of most businesses and forced them to quickly adapt their financial and budgetary policies and plans. Since the technical term of setting a budget is considered as a budget process, accountants view the process of monitoring how the budget is spent as a budget control (Abernethy and Brownell, 1999). Budget control represents a widely implemented mechanism to evaluate the performance of managers and to communicate objectives, strategy and planning process, how an organization is able to achieve the desired result by closely monitoring costs. Therefore, it is often also used as a tool to form managerial and supportive behaviors of managers, consistent with organizational objectives. However, the level of participation and support depends on the budgeting approach of the top management of the organization (Jensen and Meckling, 1976). Many firms recognize the need to have a developed and comprehensive budget control system in order to minimize changes, budget costs, and maximize efficiency (Mattei, Jorge and Grandis, 2020). Budget control is just as important as the cash itself and any theft, loss, overuse or reserve can lead to poor business performance. An organization's resources must be managed effectively and efficiently to achieve its purpose. This means that the organization must be able to achieve its objectives while minimizing cost. Thus, management means coordinating and controlling the efforts of the organization to achieve the objectives of the organization.

Jorge, Jesus and Laureano (2018) stated that the management process is facilitated when management anticipates its future course of several objectives and makes decisions in a professional manner, using the efforts of individuals and stakeholders in a rationally coordinated manner. A systematic approach to achieving effective management performance is budgeting. Budgets are monetary expressions of goals that must be met in a given year by an individual, organization or nation. It is a deliberate attempt to achieve superior goals over time with available and expected resources. Such intentions are influenced by past experiences and expectations for the future (Manafe and Setyorini, 2019). Budget control is the system of controlling costs through budgets. It involves comparing actual performance with budgeted performance with the aim of ascertaining whether or not what was planned agrees with actual performance. If deviations occur, the reasons for the change are ascertained and corrective action is recommended to match the current performance with the plans. The basic objectives of budget control are planning, coordination and control. It is difficult to discuss one without mentioning the other (Susanti, Eprillison and Jolianis, 2018). Nowadays, organizations all over the world, both private and public, have realized the need to restructure and repair their activities for a better model of service delivery. One of the most fundamentally affected aspects of these organizations is budgeting and budget control. Recognizing the role of budget and budget control, organizations depend heavily on it. In the private sector, several departments have been established, the main purpose of which is to implement and monitor budgets. In the public sector, budget monitoring and project implementation committees have become an integral part of administrations. For efficiency and effectiveness, different firms in Albania need to plan to achieve success. How are they currently doing in terms of specific planning and budgeting? In recent times, companies have performed poorly due to the fact that they lack effective and efficient budgets and budget control systems to adequately and reasonably allocate resources to meet organizational goals, and maximize performance. A study conducted by Susanti, Eprillison and Jolianis (2018) founded that companies continue to err and fail because they have faulty budget planning and control systems, which they apparently fail to recognize. Some firms feel the weakness of their budget analysis but see them as individual problems rather than as systemic shortcomings. They misuse efforts and produce greater disappointment. As a result, corporate strategy and capital allocation become wrong and remain so, despite unacceptable financial performance. Some business organizations do not even know the connection between budget control and performance, and this negatively affects their performance. The main objective of this study is to examine whether budget planning, budget control and risk monitoring affect the financial performance of businesses. The purpose of this paper is to justify the chosen theoretical framework that shows specific practices applied by multiple organizations in order to facilitate their performance. Thus, this perception and applicability of the framework will be tested by interviews and expert responses to assess the influential aspects of the risk management process. In addition, these practices and tools need to be redirected to the financial institution's corporate strategy in order to have an integrated structure of risk management and budget planning, which is embedded in the organizational culture.

LITERATURE REVIEW

Budget monitoring is important to ensure that financial, operational and capital plans that have been drafted and approved for implementation as part of budget processes are being implemented. Budget monitoring is essential for an organization to be able to enforce cost accountability. In addition, regular and comprehensive budget monitoring allows management to evaluate service level assurance, provide any new initiatives it is making for expected progress toward goals, and learn more about other trends and deviations that may affect in future operations. Budget monitoring should include the examination of a wide range of functions in order to fully inform what action should be taken if significant deviations are found. Comparing the budget with current data is the starting point for budget monitoring, but it needs to be expanded to include how the organization is performing in relation to the delivery of its services and products. To ensure this, management must clearly articulate not only the elements and who will be analyzing, but also how to use the analysis. If carried out consistently, thoroughly and effectively, the budget monitoring process will provide information that can lead to corrective action or operational improvement (Diamond and Khemani, 2006).

Mattei, Jorge and Grandis (2020) have argued that managers can make budgets to control the activities for which they are responsible. Analysis of variance allows managers to identify those costs that are inconsistent with the long-term plan and may therefore require changes. By investigating the reasons for budget deviations managers may be able to identify inefficiencies. The budget forms the basis of a control mechanism for the various resources of an organization that is achieved by comparing the source measured at the end of a given period with what was expected. This approach can be used for all measurable resources and activities within the organization - not just those that are directly financial. Budget control highlights changes from those expected so that management can take remedial action to ensure that the policy objectives set out in the budget are met. It is an ongoing monitoring process and requires constant updating and budget change through operational feedback. It also allows performance to be measured against objectives or targets. A report by Harelimana (2017) taken mainly from practitioner literature, cites a dozen budget control weaknesses ranging from wasting time, being a hindrance to change, budgets focusing on cost reduction rather than value creation, up to to budgets that make staff feel underrated. While not everyone would agree with these criticisms, the criticisms of Diamond and Khemani (2006) also support the perception of widespread dissatisfaction with budgeting practices. Swalhi, Zgoulli and Hofaidhllaoui (2017) noted that budgeting facilitates sales and production coordination, formulating a profitable sales and production program, coordinating sales and production with finance, and coordinating all operations within the business. While this is so, the business sector has failed to fully enjoy these benefits as a result of failure in effective budget planning and implementation.

Risk conceptualization caught the spotlight for many researchers and practitioners, due to the fact that an accurate risk definition is inevitable in order to be successfully identified, measured, controlled and governed. Although a clear definition of risk is essential, its definition can change substantially given some values associated with potential side effects, so quoting a single definition of risk is challenging. Moreover, the interpretation of risk is fundamentally controversial, so the choice of a definition may affect the outcome of resource allocation, energy allocation, and policy discussions (McGuire, Sundgren and Schneeweis, 2020). The key step in determining risk is to specify the consequences to be considered (Dekker, Groot and Schoute, 2012). Next, the definition of risk is related to the approach to aspects of risk. According to Princy and Rebeka (2019) risk can be viewed from two different perspectives, one is the negative conceptualization of risk which presents the notion as an exposure to a possible sudden loss. However, due to a neutral perception, risk can also be assumed as an opportunity that yields different results from those originally considered (Putri and Solikhah, 2018). According to Swalhi, Zgoulli and Hofaidhllaoui (2017), risk can be considered as a distinction between subjective and objective interpretations of probabilities. Moreover, he distinguishes between uncertainty and risk. According to Caruana (2016) statistical probabilities describe measurable uncertainties, being defined as risk, however immeasurable probabilities which are caused by inherent symmetry are defined as uncertainties. Then, in today's economy these two terms are considered as common terminology, therefore modern financial and economic literatures do not distinguish between them. In general, risk includes two main components, based on which it can be measured and understood, namely uncertainty and exposure. The conceptualization of financial risk narrows the context in which risk is defined, so it can be said that financial risk refers to exposure to an indefinite degree of uncertainty, which is an essential element of pursuing business activities (Kerosi, 2018). However, financial risk can be interpreted as any fluctuation that changes a company's cash flow statement, financial results and specific corporate objectives at the expense of an additional risk-taking activity by shareholders to obtain and maximize the economic result of the a specific investment. Thus, it supports opportunistic behaviors in relation to potential future risks that may result in positive or negative consequences (Bergmann and Fuchs, 2017).

The importance of budget has always revealed contradictory findings among scholars. Mmari and Thinyane (2019) reported negative correlations between participation and performance. On the other hand, Princy and Rebeka (2019) found that participatory budgeting is used more often than central management and also when part of the manager's reward package is related to budget performance. Budgeting increases acceptance and motivation, as well as makes the person preparing the budget to a greater extent feel responsible for the goals of the organization (Susanti, Eprillison and Jolianis, 2018). Rewards are techniques of increasing productivity (behavior management) that aim to provide motivation. This is based on the idea that a behavior that leads to a positive consequence tends to be repeated. Employee participation in the budget preparation process also motivates them to achieve budget goals (Dabbicco and Mattei, 2020). Gomera, Chinyamurindi and Mishi (2018) advocates full participation and argues that all individuals responsible for achieving results should be consulted in formulating budgets. No budget control system can succeed without the mutual understanding of superiors and subordinates. Participation ensures full cooperation and commitment to make budgets successful. Participation also makes budgets realistic and workable. Budgets are used to achieve cost effectiveness, in planning, for operations, coordination of activities, motivation of performance, communication of plans and operations as well as in evaluation and audit (Carr, 2000).

METHODOLOGY

A descriptive research model was used in this study. Main data for the analysis of the impact of controls and budget planning on financial performance were collected using a questionnaire, in order to know the importance of budgets as a tool of financial management between firms. The questionnaires were distributed to the managers and financial employees of the selected firms, in order to obtain appropriate and accurate information from the people who have the main data collection instrument. The reason for choosing questionnaires is because they are less costly, convenient and not one-sided. Also, the way in which the primary data for the analysis of the risk oversight were collected was realized through expert interviews. Expert interviews allow for an expanded elaboration of expert knowledge focusing on technical knowledge, related to process and interpretation-evaluation, thus relying on the conscious understanding of a specific field of social science (Dabbicco, 2018). Secondary data include budget data of various firms and their financial records, as well as various data related to the budget against current changes, revenues versus costs, etc. These were used to supplement raw data. In the research, it is used a combination of quantitative and qualitative methods. Since the purpose of the study was to determine the impact of budget controls and risk oversight on the financial performance of an enterprise, it was considered important to use quantitative research, as it will provide the right information that will facilitate the cause-and-effect relationship. Furthermore, quantitative research is preferred to analyze the impact of budget controls due to the nature of the research because no variables were manipulated, and a correlation model for data analysis was used to make generalizations about the sample population. The data collected in quantitative research exist in numerical and quantitative form and can be easily subjected to various statistical tools.

ANALYSES AND FINDINGS

350 questionnaires were distributed to financial managers in economic units located in Tirana and Durres, where of these, 312 respondents completed and returned the questionnaires. Given that it is interesting to learn about the time dimensions of budget coverage of entities, most financial managers showed that they have the largest percentage in companies 1-5 years with 71%. The study wanted to find out how often budgets are reviewed in companies in Albania. According to the results, most respondents indicated that their budget is reviewed quarterly by 55%. This study focused on revealing the approximate annual budget revenues. According to the findings, most respondents indicated that they had an approximate budget of ALL 125 000, with 46% of responses. According to the answers to the questionnaire, 73% of them had work experience in the interval of 4-10 years. The study was to find the level of agreement of respondents on statements related to the importance of budget control in organizations. According to the results, most respondents agreed that budget control integrates the organization's strategic planning with budgets and cost control processes, budget control identifies the budgeting/financial capabilities required for better decision making, identifies key financial indicators for the business and when they are to be monitored, budget control identifies sources of finance and business data that provide insights into business and financial strategies when converted into budgets, budget control helps to interpret budgets and performance measurements as communication tools and ultimately helps to actively thought beyond budgeting and that budget control also saves management time using management. As can be seen from the table 1, the value of the definition coefficient (adjusted R2) is 0.825 for all studied variables (planning, monitoring/control and participation in budgeting).

Table 1. Model Summary

Model	**R**	**R^2**	**Adjusted R^2**	**Standard Deviation**
1	0.912	0.83	0.825	1.15635

This means that independent variables (planning, monitoring/controlling and participating in budgeting) explain 82.5% of financial performance in the manufacturing companies surveyed.

Table 2. ANOVA - Analysis of Variance

Model	Sum of Squares	Degrees of Freedom	Mean Squares	F	Importance Level
Regression	201.545	1	201.545	151.151	0.00001
Residues	52.757	41	1.314		
Total	254.302	42			

In the study, F statistics were used to determine the suitability of the regression model to give reliable results. A value of F from p = 0.000 was created. This indicates that the regression model has less than 0.001 probability of giving an incorrect prediction.

Table 3. Coefficient Results

Model	Non-Standartized Coefficents	Non-Standartized Coefficents	Standartized Coefficents	t	Importance Level
	B	Standart Deviation	Beta		
Constant	10.650	1.735	-	6.141	0.000
Planning	0.415	0.036	0.615	11.525	0.010
Monitoring/ Controlling	0.422	0.000	0.665	7.015	0.036
Participating in Budgeting	0.045	0.015	0.008	0.104	0.023

The results of the study show that there was a positive relationship between borrowing rates and forecasters (planning, monitoring/control and participation in budgeting), and financial performance in a manufacturing company. Non-standardized regression coefficients show how the dependent variable (financial performance) changes when the independent variable (planning, monitoring/control and budgeting participation) changes by 1 unit. This means that an increase in budget planning would lead to an increase in financial performance in the company by a factor of 0.415. An increase in the unit in participating in budgeting would affect the financial performance in the company by a unit of 0.045. An increase in the monitoring/control unit would also lead to an increase in financial performance in the company by a factor of 0.422 and vice versa. Standardized regression coefficients are based on changes in standard deviation units. The value of the coefficient (planning, monitoring/control and participation in budgeting), means that an increase in the standard deviation in them leads to the financial performance in the company will an increase by 0.615, 0.665 and 0.008, respectively. The results further show that there is a significant relationship between financial performance in the company and three variables (planning, monitoring / control and participation in budgeting), as indicated by the value of p ($p = 0.000 < 0.05$).

Consistent with the initial assumption, a strong correlation portrays the relationship between risk management and financial stability. Rational risk management ensures the reduction of certain reserves, which increases the liquidity of an organization by supporting an overall positive performance related to the health of its financial system. Financial stability can be measured based on the capital and liquidity position of an organization. Thus, a strong interplay can be observed between the risk management process, working capital and financial stability. This relationship stems from the fact that financial stability depends on the working capital of an organization, for the fact that there is a proportional correlation with respect to an organization's risk-bearing capabilities arising from the reserves held to finance potential risk exposures. Thus, according to this understanding in case of a risk management process, the working capital of the organization should be adjusted proportionally in relation to the accepted financial risks, in order to maintain its financial strengths. Failure to do so will result in critical losses and financial turmoil. Furthermore, in order to provide a more in-depth elaboration of this aspect, it can be said that working capital serves as a solvency ratio, which estimates the required amount of money that an organization must possess in order to perform efficiently. By doing so, a balanced equity and liquidity position illustrates a sound financial system from an organizational perspective. Therefore, a strong correlation can be observed between organizational performance and the sustainability of the financial system.

However, in favor of a systematic process of identifying and assessing financial risk, risk management contributes to a small proportion to one's financial stability by encouraging the development of several risk management action plans in order to ensure a proactive approach. to financial risks. With this tool, within the risk management process, managing the risks of the organization's portfolio can also contribute to its financial stability. This conception is supported by the fact that the risk associated with specific portfolios may affect the normal functioning of the entire system, so the diverse risks associated with the portfolio should be determined accordingly. In addition, measures of financial stability such as GDP, volatility, country risk and many others, should also be taken into account during a careful risk management process due to the fact that these measures have a direct impact along with an indirect impact on the outcome of the risk governance process. In turn, increased attention should be paid to regulatory requirements that may shape the outcome of the management process due to the fact that these regulations may affect sustainability through the applied risk management method and defined risk capabilities. As previously discussed, an adequate risk structure and risk profile can facilitate the creation of the necessary working capital that must exist to support an organization's financial performance. Thus, it can be justified that there is an indirect impact between risk management and financial stability, and more precisely, the weaker the risk governed, the greater the risk of a financial disaster occurring, which causes financial instability.

CONCLUSIONS

The need for Budget Control - The study concludes that:

a) Budget control integrates the strategic planning of the organization with budgets and cost control processes.

b) Budget control identifies the financial capabilities required for better decision making.

c) Identifies the main financial indicators for the business and how and when they should be monitored.

d) Budget control identifies sources of finance and business data that provide insights into business strategies.

e) Budget control helps interpret budgets and performance measurements as communication tools.

f) Helps to think actively beyond budgeting.

g) Budget control also saves management time using management by the extraordinary principle.

Essential elements of an effective budget control system - The study concludes that:

a) Companies set budgets that are reasonable and achievable.

b) The responsibilities of the budget manager and budget control are clearly defined.

c) Effective accounting records and procedures are clearly understood and applied.

d) There is an information system that provides data for managers so that they can make realistic predictions.

e) Support and commitment of senior management for the budget control system is appropriate.

f) Review budgets where changes are needed to make them appropriate and useful.

g) Sampling companies acknowledge that budget control is a management activity and not an accounting exercise.

h) Sampling companies ensure that there is participation of managers in the budget control system.

Budget Control (Planning) - The study concludes that:

a) Their budgets have clear goals and objectives.

b) Their organization has long-term and short-term budget plans.

c) All departments prepare budget plans before the budget year.
d) Budgeting, goals and objectives of the results are related to the programs.
e) Budgets cover all aspects of the organization.
f) Managers set priorities for next year in budget committees.

Monitoring and Control - The study concludes that:
a) Budget deviations are reported to the budget committee/executives.
b) Deviations from budget targets are often reported.
c) Activity costs are always reviewed by the executive committee.
d) Managers hold regular budget meetings to review performance.
e) Managers always take corrective action at times when adverse changes are reported.
f) The control of budget activities is done by the head of departments.
g) Managers or their equivalent have budget policies to control spending.
h) A comparison is made between current plans and performance and the change is often reported.
i) Budget performance evaluation reports are prepared regularly.

Participation in Budgeting - The study concludes that:
a) Financial managers or their equivalent are involved in the budgeting process.
b) The financial manager or equivalent has been sensitized in the budget control process.
c) Each department prepares a budget before the general budget.
d) All stakeholders in the budget are included.
e) All departments are always involved in the budgeting process.
f) Approved budgets are shared with all departments.
g) Leadership and support is given to all subordinates throughout the budget by managers.
This study recommends that managers continue with the motive of evaluating budget control in their policies (planning, monitoring/control) as well as advocating for participation in budgeting as it has been found to affect financial performance to a large extent. It is also recommended that managers develop detailed budget plans to enable the implementation of the long-term or strategic plan.

LIMITATIONS

The study is focused only in the companies in Durres/Tirana and not all companies in the economy, therefore, this research in the future should be carried out including also the companies that operate in other cities. It would be of interest to carry out the same analysis in several countries similar to Albania, to make a comparative analysis between countries in terms of budgetary control and the impact in financial performance.

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