# Public and Private Sector Budgeting Differences

Posted on May 11, 2020

Budgeting is very crucial to both public and private organizations. Budgets are used as a tool for planning and control in most organizations. Budgeting provides a system of planning, control, and coordination of management. The budgeting process in the public sector and private sector differs in many ways. The budgeting process in the public sector can be more difficult than the private sector budgeting process since the objectives of the public organization are sometimes difficult to define in a quantifiable way as compared to the private organizations. Budgeting in both the private and public sectors involves the coordination of financial and nonfinancial planning to attain the goals and objectives of an organization.

## Different Goals and Measures of Success

Private sector budgeting's aim is usually to maximize profit, while public sector budgeting's aims may be largely qualitative, making it difficult to quantify. Similarly, the output of the budgeting process in public organizations is difficult to quantify, unlike the private organizations where the output can be measured regarding the sales volumes. Budgeting in the public sector is important because a large share of the income of a nation is allocated and managed through public budgets. The government uses the budget to decide how much to spend in each ministry and budget within the available revenues to avoid overspending (Kelly 309). Public budgeting is a tool to regulate relationships across public organizations. Budgeting acts as an allocative, managerial and accountability tool for the public sector. As an allocative tool, a budget is used to set the limit on the overall public spending and break it down by organizational unit or by purpose (Khan and Hildreth 72).

## Public Accountability and Performance

Public budgets are used for management and performance measurement by assigning objectives to the public manager and later holding the manager accountable for their achievement. Also, public sector budgeting ensures that the government is held accountable for its legislative role by the citizens (Kelly 309).

## Incremental Budgeting in the Public Sector

Public sector budgeting majorly relies on the incremental budgeting system where the previous year's budget is carried forward to the next year's budgeting. The new budget, predicated upon last year's

budget, is adjusted for factors such as new legislative requirements and inflation. The budgeting process is incremental in the sense that it is concerned with the additional adjustments to the existing budget. Incremental budgeting in the public sector suits both the spending departments and treasury departments since it gives a sound basis for increases and decreases in the budget and it also assures continuity of operations (Wu 3).

## Benefits and Limits of Incrementalism

The incremental approach of budgeting in the public sector reduces the conflict between spending departments and the treasury departments since it's easy to agree on small increases or decreases (Wu 6). Since most organizations and decision-makers lack factual and causal information to facilitate effective calculation of the expenditure and need for future spending, incremental budgeting is usually preferred to ensure that only minor adjustments are made to the existing programs. Preceding-year allocations are incremented to arrive at the budget figure for the year. One limitation of incremental budgeting in the public sector is that it does not allow for inflation, and it's based on the assumption that all present public expenditures and costs are the same and do not need any scrutiny. The effect of this budgeting method in the public sector is the embezzlement of funds by the managers who spend money for the sake of it in the previous period. The managers do not care about the inefficiencies in the previous budgeting period and transfer them to the next year's budget.

## Zero-Based Budgeting and Resource Allocation

The United States of America uses the zero-based budgeting system, which responds well to the changes in the business environment and results in the more efficient allocation of resources with the changes that are occurring. Zero-based budgeting in the public sector allows businesses to re-evaluate the activities of the budget year from zero. There are no assumptions that the resources allocated in the previous years are suitable for the current or next year. Therefore, zero-based budgeting promotes effective resource allocations.

## Managerial Justification of Public Expenditure

Zero-based budgeting ensures the effective use of resources by ensuring that the managers justify every budget activity in their department. The resulting output of this system of budgeting is financial in that the accountability of the managers on the use of the resource is strictly monitored. Expenditures that are unnecessary are eliminated in the next budgeting period, and this helps to reduce wasteful public expenditures (Anessi-Pessina 501).

# Economic Political and Management Perspectives

Public sector budgeting is studied from three perspectives, which include economics, management, and political science. In terms of economics, the budget process looks into the nature of public goods and the efficiency of allocation of those goods and services provided by the government. The political science view of public sector budgeting shares the same view of incrementalism, which has it that the budget changes only marginally from one year to the next. The management perspective of public sector budgeting is associated with public administration (Khan and Hildreth 168).

# Performance Information in Public Budgeting

The use of performance information in the public sector budgeting process leads to improved allocative and productive efficiency as well as financial discipline (Curristine, Lonti and Joumard 12). The incorporation of performance information in public budgeting has improved expenditure control and public sector management. Performance information initiatives concentrate on measurable results of budgeting and divert attention from inputs and processes. The widespread adoption of performance information is linked to its value in assessing the performance of public sectors.

# Linking Expenditure to Measurable Results

Another form of the budgeting process in the public sector is performance budgeting, which is concerned with the use of information in the process of budgeting and allocation of resources. Performance budgeting relates the budget expenditure to measurable results. However, one nonfinancial benefit of performance information in budgetary decision-making is that it can be used at different stages and levels of the budgeting process in the public sector.

The output information of most budgetary negotiations includes estimates of what is expected after incurring expenditures, for example, how many roads or hospitals are built. Performance information is used by many ministries in resource reallocation to link individual manager performance with that of the organization and for the purposes of rewarding and issuing bonuses (Curristine, Lonti and Joumard 17).

# Performance Transparency for Citizens

Performance information evaluation for the citizens informs their choice about local schools and hospitals, as seen in countries like Australia and the United Kingdom (Curristine, Lonti and Joumard 21). The information provided is used as guidance to the level of performance and service provision. The information highlights sectors that are not performing and might need to improve in the future.

# Profit Forecasting and Cost Control

Most private sectors budget to spend less and sell more of their products to maximize profit. In the private sector, budgeting is used to predict operating results. The expenditure and budgeting in the private sector follow strict financial management control by ensuring that expenses on assets and services are monitored to cut costs. Planning and forecasting of estimated revenues and expenses are made before calculating in advance the projected profit margin. However, in the public sector, revenues are derived from taxes, fees, and services offered by the local authority.

# Private-Sector Transparency and Quantifiable Output

Budgeting in the private sector has little transparency, although some privately listed companies disclose their financial information as a requirement by most security exchange commissions. The result of the private budget process being concealed leads to issues with transparency and less trust from the public. In private sector budgeting, unlike the public sector, output is easy to quantify since measures such as sales volumes and profit margins are used. The ease with which outputs can be quantified in the private sector budgeting process allows private organizations to decide on bonus issues and related rewards to the employees and the management (Anessi-Pessina 530).

# Shareholder Value and External Consultation

Private sector budgeting is usually intended to minimize cost and maximize shareholders' value, which entails increasing revenues, controlling unnecessary costs and increasing cash flows to the business. The budgeting is tailored to cover only expenses and to project the target profit by the management. There is a difference in the public sector and private sector degree of consultation during the budgeting process. In the public sector, the budgeting process is external since there is a wide group of stakeholders, so the engagement process is quite lengthy. It involves a wide consultation of the business community, the citizens, politicians, and trade unions. These groups are given an opportunity to review the budget before it is finally implemented.

# Internal Consultation and Manager Incentives

In the private sector, the budgeting consultation is internal since the stakeholders are few, and they are the ones affected by the budget. The financial implications of budgeting, such as failure to meet the targets, are felt by the management and shareholders. In the event that the managers achieve their target, they are rewarded with bonuses, which are financial. Some of the non-financial outputs of meeting the budgeting target include a good reputation for the company regarding excellence and

gaining market share.

## Long-Term Planning and Beyond Budgeting

The private sector has developed a long-term approach to budgeting to incorporate long-term revenue contracts. The private sector can reasonably predict costs and income over a long period. Sometimes, private companies use a rolling budget of ten years to project finances and the expenditure requirement. Due to the extreme shortcoming of the traditional budgeting method, the private sector has adopted the beyond budgeting methodology. Beyond budgeting ensures that all the integral elements of the organization are taken into account. The outputs of the beyond budgeting methodology in the private sector are majorly non-financial, and they include increased integration, alignment of the business planning process and strategic plans of private organizations (PwC 25).

## Strategy and Performance Management

The private sector budgeting process is linked to strategy and performance management. They incorporate both the balanced scorecard approach with beyond budgeting to draw strategic plans and implement them into actions. The aim of the performance management and setting of the strategy is to ensure that private organizations perform better than competitors in the same industry.

Strategy and performance management systems are achieved by ensuring that the employees are evaluated based on their contribution to the performance of the organization. The financial implication of proper strategic planning and performance management implementation in the budgeting process of the private sector organization leads to increased profitability and a long-term view of the company's goals and mission.

## Incremental Methods in Stable Markets

Incremental budgeting is also popular in the private sector because it requires fewer resources in its implementation, and it is also more appropriate where expenditures and revenues are stable and predictable. However, the non-financial output of this method in the private sector budgeting process is that it leads to bias by supporting the status quo. Adoption of a more driver-based approach or the use of zero-based budgeting could lead to better use of money, efficiency, and reduction of costs.

## Flexibility Innovation and Entrepreneurship

The budget process in the private sector is characterized by the freedom of greater flexibility, unlike the public sector budgeting process. Flexibility is seen regarding how targets are achieved, and the way managers have the freedom to spend money if it leads to more profitability. This is more difficult

in the public sector since there is no direct link between expenditure and the generation of revenues. Therefore, the private sector budgetary process allows room for innovation and entrepreneurship (PwC 28).

## Adapting Budgets to Financial Change

The approach to budgeting processes in both the private and public sectors is not at a standstill because financial pressure encourages organizations to change. The need to match the budgeting approach to the environment makes organizations more effective and responsive to change and profitability, especially in the private sector.

## Performance Appraisal and Clear Organizational Goals

The incorporation of performance management in the private sector budgeting processes, which entails good performance information and performance measurements that stimulate and measure performance, has led to a fair performance appraisal system that recognizes that circumstances can change over time. Performance management in the budgetary processes in the private sector encourages clear articulation of goals, achievement of goals and objectives and clarity on each contribution to the objectives of the private sector organizations.

## The Public-Sector Performance Information Gap

The use of performance information is an area lacking in the public sector that needs improvement. There is a lack of understanding of how to interpret and implement performance information in the budgetary process, unlike the private sector, which has developed new approaches in this area to improve the budgetary process and the environment.

## Benefits of New Private Budgeting Approaches

Some of the attributed benefits that the private sector has gained from developing new approaches to the budgeting environment and process include a new management information system for accurate decision-making, an improved budgeting process based on what drives expenditure and the impact of these expenditure drivers across the organization, alignment of the budgeting process to the business, and the use of rolling budgets, which encourage proper budgeting and decision-making (PwC 75).

# Corporate Accountability and Employee Rewards

The private sector budgeting process also focuses on the accountability of the managers and good corporate behaviors by setting targets that are holistic and not individual targets. The budgeting process also encourages innovation and rewarding of employees by ensuring that spending is geared towards achieving certain targets and initiatives.

# Public Adoption of Long-Term Budgeting Practices

The public sector organizations have also embraced this direction, as evidenced by governments encouraging proper spending to save, a long-term view of budgeting and the use of rolling budgets to cut financial costs.

# Works Cited


Wu, F. H. Incremental Budgeting: A Decision Model. Management Accounting, (1976): p. 57-46.
Khan, Aman, and W. Bartley Hildreth, eds. Budget theory in the public sector. Greenwood Publishing Group, 2002.
Curristine, Teresa, Zsuzsanna Lonti, and Isabelle Joumard. “Improving public sector efficiency: Challenges and opportunities.” *OECD Journal on Budgeting* 7.1 (2007): 1D.

Anessi-Pessina, Eugenio, et al. “Public Sector Budgeting: A European Review of Accounting and Public Management Journals.” *Accounting, Auditing & Accountability Journal*, vol. 29, no. 3, 2016, pp. 491-519

Kelly, Janet M. “The Long View: Lasting (and Fleeting) Reforms in Public Budgeting in the Twentieth Century.” *Journal of Public Budgeting, Accounting & Financial Management*, vol. 15, no. 2, 2003, pp. 309

.PwC: *Good Budgetary Processes*, Research report commissioned by the National Audit Office, 2002, p. 25-75.


Copyright © 2026 Academic Master. 