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Chapter

The Impact of Institutional and Political Factors on Timely Adoption of Local Community Budgets

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Abstract

When preparing a budget, local authorities are faced with a problem of implementing all statutory tasks while maintaining a balanced budget both from a financial point of view and from the aspect of satisfying common needs and interests of citizens. All these factors are reflected in the timely adoption of a budget. Our fundamental hypothesis is that in their efforts for timely adoption of a budget, local communities face institutional and political factors. If the budget of the local community is not adopted on time, local communities, in the case of Slovenia, are financed only on a temporary basis. An example of an institutional factor is the cooperation between a mayor and a finance manager in preparation of a budget (the first factor). An example of a political factor is the clarity of informing a municipal council (the second factor) which is the decision-taking body of a local community, since both the mayor and municipal council are elected politically. To this end, we have set two hypotheses. The first hypothesis is that the first mentioned factor is an important factor for timely adoption of a local community budget. We checked it with the discriminatory analysis. The second hypothesis is that the clarity of informing a municipal council by a mayor is an important factor for the timely adoption of a local community budget. We checked it by testing the difference between the arithmetic mean for two independent samples. The sample consisted of 122 local communities out of 212 population. Based on theoretical background and research, we have drawn recommendations to local communities for timely adoption of budget which consequently allows financing and performance of municipalities’ tasks.

Keywords: local community, municipality, budget, council, finance manager

1. Introduction

The Constitution of the Republic of Slovenia in Article 138 states that residents of Slovenia exercise local self-government in municipalities and other local communities. Article 139 further specifies that municipalities are self-governing local communities. The territory of a municipality comprises a settlement or several settlements bound together by the common needs and interests of the residents. A municipality is established by law following a referendum, by which the will of the residents in a given territory is determined. The territory of the municipality is also defined by the law. According to Article 140 of the Constitution, which defines the scope of local self-government, competencies of a municipality comprise local affairs which may
be regulated by the municipality autonomously and which affect only the residents of the municipality. By law, the state may transfer to municipalities the performance of specific duties within the state competence, if it also provides the financial resources to enable such. "In recent years, both Russian and foreign researchers have given much attention to the development of local government" [1].

Local self-government is one of the fundamental principles in the Constitution of the Republic of Slovenia, with Article 9 stating: "Local self-government in Slovenia is guaranteed" [2].

The financing of the performance of duties within the municipality competence is regulated by the Financing of Municipalities Act, which in Article 3 states that the municipality financing shall be based on the principles of local self-government, mainly on the principle of proportionality of sources of financing with the municipality tasks and on the principle of independence of municipalities in financing municipality tasks. In Article 5, the act separates the financing of tasks within the state competence from the financing of tasks that municipalities must perform as part of their competencies, defined by the relevant laws. When drawing up the local community budget, the municipalities must comply with the applicable legal framework on public finance and accounting.

For a local community to be able to perform all the tasks in a certain calendar year, it must have the funds for its own operations and be financially independent. This means that it must adopt a budget, i.e., a financial plan it would follow in that year in time. Municipalities may also borrow money for individual tasks and investments, provided they comply with the legal framework.

Budget is a yearly financial plan, adopted in advance, in which the state or local community plans its revenue and expenses for fulfilling the needs of the public, with the municipal budgets being adopted as ordinances and the state budget as a legal act sui generis [3].

Drawing up a budget is an extremely important task of central and local authorities’ executive bodies. This topic is also stressed in the works of George and John [4] and Copus [5]. Initiating and drawing up the budget in individual countries are generally regulated by budget laws, which specify the rights and obligations of individual budgetary authorities [6]. Under the law, the mayor represents the municipality and proposes the municipality budget to the municipal council for adoption, so it is important for the mayor to approach budgeting with all responsibility. McIlquham-Schmidt [7] identifies strategic planning as an effective way for improving the performance. However, a closer empirical review of the literature on the topic shows a greater diversity of findings. Some studies show a positive correlation between strategic planning and performance, which includes the relationship between employees [8], while others have found no correlation between the two [9]. These authors define planning differently, with the main point being the planning of future operations in companies as well as local communities, by focusing on 1- or 2-year plans for achieving the set goals, whose content and financial value are specified in the budget.

According to Shack [10], surveys have shown that when drawing up the budget at the state level, the level of political involvement increases. Municipal council members, on the other hand, are usually less intent on getting involved in local community budget planning.

A study from Denmark has shown that while the councilors listen to the citizens’ comments and suggestions, they do not necessarily forward and defend them in the further process. Many local politicians are very interested in having a dialog with citizens, as this increases their chances of getting reelected [11].

Budget is the result of a compromise between the interests of political parties and other stakeholders [3]. The weight of individual financial sources (own sources, state funding, borrowing) in a local community affects the adoption of the budget.
Institutional and political factors play a big role in the timely adoption of the local community’s budget in Slovenia.

“Politicians are generally less interested in establishing performance municipality budgets than top managers, particularly chief financial officers” [12]. So, we claim that collaboration between the mayor and finance director in drawing up the budget is needed, since finance directors play the main role in preparing the municipal budget. We take collaboration between the mayor and finance director as an example of an institutional factor. Clarity in informing the municipal council is an example of a political factor, with the council as the local community’s decision-making body and the mayor all being elected. Findings in other research have shown that “political strength have a significant effect on the level of transparency in management of public resources” [13]. Other findings stated that “most projects are developed in narrow political circles including mayors, councils, municipal CEOs and semi-public organizations” [14].

A municipal budget is adopted for a financial year that starts and ends on the same dates as the state budget financial year. The mayor must present a draft budget to the municipal council within 30 days of the state budget being presented to the National Assembly. In the year when regular local elections are held, the mayor has 60 days to present the draft budget after the council is elected. A municipal budget is adopted for a financial year that starts and ends on the same dates as the state budget financial year. If the budget is not adopted before the start of the relevant year, it is deemed as not adopted on time. In this case, the mayor makes a decision on temporary financing for a period of up to 3 months, which can be extended by the council adopting a decision at the mayor’s proposal.

Finance directors are present at council sessions when budgets are being adopted and have insight in the clarity of information exchanged between the mayor and the municipal council. The clarity of information provided to the municipal council affects the timely adoption of the budget. Out of 24 Council of Europe countries, 8 have adopted laws regarding collaboration between the mayor and politics (represented by the municipal council) in adopting the budget, specifying the processes and deadlines for preparing drafts. In general, they stipulate that the mayor must inform the representatives of people (the municipal council selected through the public vote) about the budget’s basic premises and assumptions [11]. Mouritzen and Svara [15] closely studied how the mayor and the politics affect each other, as well as how political and executive actors impacted the local legislative body (Haček, Kukovič, and Grabner) [16].

2. The purpose and methods of work

This paper aims to examine the impact that institutional and political factors have on the timely adoption of a local community’s budget, with a special focus on the adoption of budgets in 2016 in Slovenia. We will use the theoretical framework and similar research outcomes to compile recommendations for local communities on how to adopt budgets on time, which then in turn allows the local communities to finance their work and perform their tasks. If the local community’s budget is not adopted on time, only temporary financing is provided to the community.

Our main thesis is that local communities face institutional and political factors when adopting the local community’s budget, which affect the timely adoption of the budget and subsequently the performance of the tasks that are carried out by the municipality, i.e., the local community. The main thesis is based on several years of experience and understanding of the issues related to adopting local community budgets. Other similar authors’ empirical research has already pointed to the issues
related to local budgets. As we did not find comparable research in the literature to ours, we fill the research gap both empirically and theoretically.

We will check the selected factors, which we believe affect the budget adoption, based on the data collected in our survey sent out to finance directors in 212 municipalities, i.e., local communities in Slovenia. Different authors have already empirically proven that some of them affect the adoption of the budget. We will test the following hypothesis:

Hypothesis 1: Trust, openness, and daily collaboration between the mayor and finance director (institutional factor) are important factors that affect the timely adoption of the budget.

Hypothesis 2: The clarity of information the mayor presents to the council (political factor) is an important factor in the timely adoption of the local community’s budget.

3. Survey results and discussion: trust, openness, and daily collaboration between the mayor and finance director

We used binary logistic regression to test hypothesis 1 that trust, openness, and daily collaboration between the mayor and finance director are important factors that affect the timely adoption of the budget. In our survey, we asked finance directors in municipalities to assess the elements of their collaboration with the mayor from the aspects of trust, openness, and daily collaboration and their impact on the adoption of the local community’s budget. They rated the elements on a 5-point Likert scale, with 1 meaning inadequate and 5 excellent.

We first analyzed their responses on trust, openness, and daily collaboration between the mayor and finance director using the Mann–Whitney U test. We compared the ratings for trust, openness, and daily collaboration between the mayor and finance director in local communities where the budget was adopted on time and in those where it was not.

We further assessed the impact that the quality of communication between the finance director and mayor had on the timely adoption of the budget using binary logistic regression.

Based on Mann–Whitney U test (Table 1), we have concluded that all three examined elements have a statistically significant effect on the timely adoption of the budget. With the risk below 0.1%, we can confirm that all three elements linked to the quality of communication have a statistically significant effect, with the score for trust, openness, and daily collaboration higher in municipalities that adopted their budgets on time.

Daily collaboration between the mayor and finance director has a statistically significant effect on the timely adoption of the budget ($U = 866.000; p = 0.000$). As a result, we accept hypothesis 1 that trust, openness, and daily collaboration between the mayor and finance director are important factors that affect the timely adoption of the budget.

In municipalities where the budget was not adopted on time, the score for trust, openness, and daily collaboration between the mayor and finance director was lower. The average score for trust between the mayor and finance director in local communities where the budget was not adopted on time was $3.41 \pm 0.923$ ($Me = 4$). The average score for trust between the mayor and finance director in local communities where the budget was adopted on time was $4.37 \pm 0.893$ ($Me = 5$). The average score for openness between the mayor and finance director in local communities where the budget was not adopted on time was $3.13 \pm 0.795$ ($Me = 3$). The average score for openness between the mayor and finance director in local communities where the budget was adopted on time was $4.37 \pm 0.893$ ($Me = 5$).
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The average score for daily collaboration between the mayor and finance director in local communities where the budget was adopted on time was 4.18 ± 0.977 (Me = 4). The average score for daily collaboration between the mayor and finance director in local communities where the budget was not adopted on time was 2.77 ± 1.008 (Me = 3). The average score for daily collaboration between the mayor and finance director in local communities where the budget was adopted on time was 3.78 ± 1.158 (Me = 4).

We first wanted to continue by conducting a binary logistic regression to assess the effect that trust, openness, and daily collaboration between the mayor and finance director have on the probability that the budget would be adopted on time. When checking for multicollinearity, we observed a moderate to strong correlation between all three input variables, which should be mutually independent (Table 2). Multicollinearity in a binary logistic regression could result in biased assessments and overblown standard errors. We have tested the appropriateness of the constructed binary logistic regression model, which included all three scores for communication as independent variables, with the Hosmer-Lemeshow test (Table 3), which revealed a statistically significant difference between the number of planned and announced budgets adopted on time ($\chi^2(7) = 17.595$, $p < 0.014$). We can therefore deduce that the constructed model was not appropriate.

| Was your 2014 budget adopted before 1 January 2014? | N | Average range | Sum of ranges | Mann-Whitney U test | p |
|-----------------------------------------------|---|---------------|----------------|---------------------|---|
| Trust                                        |   |               |                |                     |   |
| Yes                                          | 78 | 74.09         | 5779           | 734.00              | <0.001 |
| No                                           | 44 | 39.18         | 1724           |                     |   |

| Openness                                      |   |               |                |                     |   |
|----------------------------------------------|---|---------------|----------------|---------------------|---|
| Yes                                          | 78 | 74.74         | 5830           | 683.00              | <0.001 |
| No                                           | 44 | 38.02         | 1673           |                     |   |

| Daily collaboration                           |   |               |                |                     |   |
|---------------------------------------------|---|---------------|----------------|---------------------|---|
| Yes                                         | 78 | 72.4          | 5647           | 866.00              | <0.001 |
| No                                          | 44 | 42.18         | 1856           |                     |   |

Table 1.
The impact of trust, openness, and daily collaboration between the mayor and finance director on the timely adoption of the budget.

| Trust                          | Openness | Daily collaboration |
|-------------------------------|----------|---------------------|
| Correlation coefficient | 1.000    | 0.818               |
| Correlation coefficient | 0.818**  | 1.000               |
| Correlation coefficient | 0.617**  | 0.722**             |
| Correlation coefficient | 0.000    | 0.000               |
| Correlation coefficient | 0.000    | 0.000               |
| Correlation coefficient | 0.617**  | 0.722**             |

**The correlation is statistically significant at the 0.01 level (2-reps).

Table 2.
Correlation between the scores for trust, openness, and daily collaboration.
Having determined that using a model with all three scores for communication quality was not appropriate, we conducted separate binary logistic regressions with separate variables.

Trust has a statistically significant effect on the timely adoption of the budget. Based on the Hosmer-Lemeshow test ($\chi^2 = 5.921, df = 7, p = 0.014$), we have concluded that this was an appropriate model (Table 4). The model explains the 29% (Nagelkerke $R^2 = 0.29$) variance in the timely adoption of the budget and has correctly classified 72.1% of the examples (Table 5), while trust is in direct proportion to the probability of the budget being adopted on time.

| Variable   | Score B | Standard error assessment | p   | Odds ratio Exp(B) | 95% confidence interval for Exp(B) |
|------------|---------|---------------------------|-----|-------------------|-----------------------------------|
| Step 1     |         |                           |     |                   |                                   |
| Trust      | .565    | .388                      | .145| 1.760             | .822, 3.766                       |
| Openness   | .582    | .415                      | .160| 1.790             | .794, 4.035                       |
| Collaboration | .209 | .256                      | .415| 1.232             | .746, 2.037                       |
| Constant   | −4.503  | 1.087                     |    |                   |                                   |

Belief ratio test: $\chi^2 = 125.911, df = 3, p < 0.001$.
Hosmer-Lemeshow test: $\chi^2 = 17.595, df = 7, p = 0.014$.
Nagelkerke $R^2 = 0.33$.

Table 3.
Results of binary logistic regression forecasting the timeliness of adopting the budget based on trust, openness, and collaboration.

| Variable   | Score B | Standard error assessment | p   | Odds ratio Exp(B) | 95% confidence interval for Exp(B) |
|------------|---------|---------------------------|-----|-------------------|-----------------------------------|
| Step 1     |         |                           |     |                   |                                   |
| Trust      | 1.195   | .261                      | .000| 3.305             | 1.981, 5.512                      |
| Constant   | −4.147  | 1.045                     |    |                   |                                   |

Belief ratio test: $\chi^2 = 130.567, df = 1, p < 0.001$.
Hosmer-Lemeshow test: $\chi^2 = 5.921, df = 7, p = 0.052$.
Nagelkerke $R^2 = 0.29$.

Table 4.
Results of binary logistic regression forecasting the timeliness of adopting the budget based on trust.

| Actual value | Forecast value | Percentage of correct |
|--------------|----------------|-----------------------|
|              | Timely adoption of the budget | No | Yes |                  |
|              |                 | 21 | 23 | 47.7 |
| Step 1       |                 | Yes | 11 | 67 | 85.9 |
|              | Total percentage |       |    | 72.1 |

Table 5.
Contingency table (independent variable: trust).

Having determined that using a model with all three scores for communication quality was not appropriate, we conducted separate binary logistic regressions with separate variables.

Trust has a statistically significant effect on the timely adoption of the budget. Based on the Hosmer-Lemeshow test ($\chi^2 = 11.12, p = 0.004$), we have concluded that this was not an appropriate model (Table 6).
Collaboration has a statistically significant effect on the timely adoption of the budget. Based on the Hosmer-Lemeshow test ($\chi^2(2) = 7.508, p = 0.057$), we have concluded that this was an appropriate model (Table 7). The model explains the 21.4% (Nagelkerke $R^2$) variance in the timely adoption of the budget and has correctly classified 66.4% of the examples (Table 8).

4. Survey results and discussion: the clarity of information the mayor presents to the municipal council

We tested hypothesis 2 that the clarity of information the mayor presents to the council is an important factor in the timely adoption of the local community’s budget
by testing the difference between the arithmetic mean for two independent samples. Finance directors are present at council sessions when budgets are being adopted and have insight in the clarity of information exchanged between the mayor and the municipal council. We asked finance directors to rate the clarity of information provided by the mayor to the municipal council. They rated the clarity of information on a 5-point Likert scale, with 1 meaning inadequate and 5 excellent.

We once again applied the Mann–Whitney U test to check whether the score for the clarity of information provided to the municipal council was statistically significantly higher in local communities where the budget was adopted on time than in the local communities where it was not.

The average score for clarity of information provided by the mayor to the municipal council in local communities where the budget was not adopted on time was 3.07 ± 0.789 (Me = 3). The average score for clarity of information provided by the mayor to the municipal council in local communities where the budget was adopted on time was 3.73 ± 0.976 (Me = 4) (Table 9).

We determined that the clarity of information the mayor presents to the municipal council has a statistically significant effect on the timely adoption of the budget (U = 1035.50; p < 0.001) (Table 10). The clarity of information provided by the mayor to the municipal council in local communities where the budget was not adopted on time was lower.

We subsequently accept hypothesis 2: The clarity of information the mayor presents to the council is an important factor in the timely adoption of the local community’s budget.

Fifty percent of the respondents from municipalities where the budget was not adopted before 1 January 2014 rated the clarity of information with 3 or 4.

5. Conclusion

Other findings indicate that “the global financial crisis has had an impact on Local Government forcing it to be more transparent in management of public resources”

| Timely adoption of the budget | N | Average value | Median | Standard deviation | Minimum | Maximum |
|-------------------------------|---|--------------|--------|--------------------|---------|---------|
| Yes                           | 78 | 3.73         | 4.00   | .976               | 1       | 5       |
| No                            | 44 | 3.07         | 3.00   | .789               | 2       | 5       |

Table 9. The effect of the clarity of information the mayor presents to the municipal council on the timely adoption of the budget.

| Rate the clarity of information the mayor presented to the municipal council | Timely adoption of the budget | N | Average range | Sum of ranges | Mann–Whitney U | p |
|------------------------------------------------------------------------------|-------------------------------|---|--------------|---------------|----------------|---|
| No                                                                           | 44                           | 46.03 | 2025.50       | 1035.50       | 0.000         |
| Yes                                                                          | 78                           | 70.22 | 547750        |               |               |
| Total                                                                        | 122                          |       |               |               |

Table 10. Mann–Whitney U for testing the effect of the clarity of information the mayor presents to the municipal council on the timely adoption of the budget.
[13]. For this, collaboration between the mayor and finance officer and between the mayor and council is necessary. Here there are summarized results of our empirical research. As we did not find exactly the same international empirical research, we will show the results of those which are partially similar in content. With our research, we have thus filled the research gap both empirically and theoretically.

We found out that the collaboration between the mayor and finance director is an important institutional factor affecting the adoption of the budget, with mutual trust, openness, and daily collaboration as the basis for good and timely performance of tasks and preparation and adoption of the local community’s budget. Other research showed that local governments, representatives, and citizens often perceive public budgeting as a difficult administrative task that should be handled by experts who have specialized knowledge, technical skills, and experience [17]; we assumed that these experts are finance directors. In our research we made a step forward and claimed that the collaboration between the mayor and finance expert in preparing the budget is necessary. Other research shows that a wise council and mayor, as the first member of the council, would not want to act without receiving a kind of advice that these experts can provide [18]. Another research shows that as the first citizen of a municipal area, the mayor is entrusted with varying roles, also with financial roles where the trust and collaboration between the mayor and finance officer is important [19]. The results of empirical research also indicate that only about 50% of managers actively participate in the budget preparation process and 67% of finance officials have very good working relations with their managers [19].

Good collaboration between the mayor and municipal council and the clarity of information the mayor presents to the council are also important for local community’s effective work. It is very important because findings indicate “city councils have the right to reject a mayor’s proposed budget”. At the municipality level, other similar findings indicate that political variables are those factors that play the most important role [20]. Another similar empirical research also shows that through citizen collaboration in the budget process, however, the distance between principals and agents became somewhat smaller, and therefore it is more likely that the budget will be adopted [21]. Also [22] argues that various cities show decreasing participation over the past years; their research with analysis of interviews with employees of public administration identified 12 individual barriers for low participation in the local budgeting. Among these barriers clarity of information was not presented by the mayor to municipal council (as representative of citizens).

This was upheld by the analysis which showed that the clarity of information presented to the councilors by the mayor affected their decision-making and the timely adoption of the budget.

Based on the analysis findings and the empirically proven impact that separate factors have on the adoption of the local community’s budget, we recommend:

- The municipal administration and finance directors should ensure all activities are conducted on time.
- The mayor should daily communicate with the municipal administration and finance directors about the activities in compiling the materials for the local community’s budget, since daily communication helps grow mutual trust and vice versa.
- The mayor should resolve any confusion in drawing up the budget with knowledge and experience and together with municipal administration and finance directors.
• Timely adoption of the budget document, in which the municipal council adopts the revenue and expenditure plan for the year. The budget must be adopted before the period to which it applies:

• Being realistic in budget planning

• Drawing up a transparent, accurate, clear, and understandable budget

• Following the principles of economical and efficient operations and looking for cost-effective solutions

• Complying with the law, all the revenue and expenditure must be based on the law, since municipalities can only do what is stipulated by the law

• The municipal administration’s body in charge of the finance must, after receiving basic economic premises and assumptions for drawing up the draft state budget in accordance with Article 18 of ZJF, send instructions for budgeting to all municipality budget’s direct users in time, providing the following information:

• Basic economic premises and assumptions for drawing up the state budget draft

• Description of the local community’s planned policies

• An estimation for the revenue and expenditure account, the financial receivables and investments account, and the budget financing account for the following 2 years

• A draft financial plan proposal for every direct budget user for the following 2 years

• The method of drawing up the municipal budget and proposed financial plans for direct users and a schedule

• The method of drawing up development and hiring plans, as well as procurement and construction plans of direct users, and the deadlines for submitting

• The method of drawing up the plan of selling municipal tangible assets and the deadlines for its submission

• The method of drawing up financial plans (separately for revenue and expenditure), development plans and explanations for direct users, and the deadline by which direct users must submit proposed financial plans, as well as development plans and explanations to the municipal administration body in charge of finance

We see an opportunity for further research primarily in looking for other factors that affect the timely adoption of local community budgets, which could include the number of municipal administration employees, the way the administration is organized, the municipal council’s political structure, and the mayors’ political affiliation. The survey should also include mayors, municipal administration directors, municipal councilors, and the Ministry of Finance. Further research should theoretically and empirically prove that other factors also importantly affect the timely adoption of the local community budget and subsequently the quality and scope of tasks that are performed in the local community [23].
The main limit of this research is that it was focused on the finance director’s perspective while not including the opinions of other stakeholders, especially the mayor and the municipal council.
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