



THE PROPENSITY OF MANAGERS TO  
CREATE BUDGETARY SLACK:  
A CASE STUDY

BY

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## **ABSTRACT**

This study puts forward the proposition that the creation of budgetary slack is dysfunctional. As such, it should be curtailed. Accordingly, since religions in general, and Islam, in particular, all preach virtuous ethics, this study posits an influence of religion on the budgetary slack creation. The study aims to investigate the propensity of managers to create budgetary slack from two perspectives: organizational and behavioral. From the organizational perspective, it has been hypothesized that budgetary emphasis, budgetary participation and slack detection influence managers' intentions to create budgetary slack. From the behavioral perspective, it is posited that culture and religion influence the budgetary slack creation. Additionally, it is also posited that religiosity makes Muslims refrain from incorporating slack into the budgets.

Data were gathered using a questionnaire survey from 63 departmental managers of the largest Korean-based company in Malaysia. The regression results indicated that budgetary participation positively influenced budgetary slack creation. The results also weakly supported that budgetary emphasis and slack detection determine the tendency of managers to create budgetary slack. There was no evidence found on the influence of national culture on budgetary slack creation from the survey. Nevertheless, the qualitative data gathered from personal interviews and other supporting materials revealed the importance of culture in explaining the propensity of managers to create budgetary slack. Interestingly, the findings suggested that religiosity, to some extent, influenced the budgetary behavior of Muslim managers. The same case was not found for the non-Muslims. Accordingly, this study has provided another insight into the argument that Muslims and non-Muslims are,

indeed, different in their underlying values especially in the context of management accounting practices.

## ملخص البحث

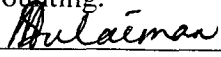
تفترض هذه الدراسة أن تقليص الميزانية هو نتيجة لإختلال الميزانية نفسها، وبالتالي يستلزم تقليصها. وبما أن الأديان عامة والإسلام خاصة يدعو إلى الأخلاق الفاضلة، فإن الدراسة الحالية تفترض تأثير الدين في إحداث تقليص الميزانية. وتهدف الدراسة لاختبار ميول المسؤولين نحو إحداث تقليص الميزانية من خلال منظورين: المنظور التنظيمي، والمنظور السلوكي. فمن المنظور التنظيمي تفترض الدراسة أن تأكيد أهمية الميزانية، وميزانية الشراكة، واكتشاف اختلال الميزانية كلها تؤثر في نية المسؤولين لإحداث تقليص الميزانية. أما من المنظور السلوكي فقد افترضت الدراسة أن للثقافة والدين تأثيرهما في إحداث تقليص الميزانية، علاوة على ذلك تفترض الدراسة أن التمسك الديني يجعل المسلمين يحجمون عن دمج التقليص في الميزانية.

وقد تم جمع البيانات بالاستبيان من 63 من مديري الأقسام، لأكبر المصالح الكورية في ماليزيا. وقد أشارت نتائج الاختبار الارتدادي أن ميزانية الشراكة تؤثر إيجاباً في إحداث تقليص الميزانية. وهذه النتائج تدعم جزئياً أن تأكيد أهمية الميزانية واكتشاف التقليص تحددان ميول المسؤولين في إحداث تقليص الميزانية. وليس هناك دليل يؤكد تأثير الثقافة القومية في إحداث تقليص الميزانية حسب الدراسة المسحية. ومع ذلك فإن البيانات الكيفية من المقابلات الشخصية، وكذلك المواد المدعمة الأخرى أكدت أهمية الثقافة في بيان ميول المسؤولين في إحداث تقليص الميزانية. ومما يدعو للاهتمام أن نتائج البحث تقترح أن التمسك بالدين يؤثر إلى حد ما في سلوك الميزانية لدى مديري الشركات الإسلامية في حين لم يثبت ذلك لدى غير المسلمين.

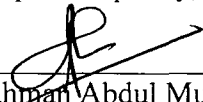
وبناء على ذلك فإن الدراسة تبين إشارة أخرى تستحق الدراسة وهي حول الجدل أن المسلمين وغير المسلمين مختلفون في النظرة إلى القيم في سياق الممارسات الإدارية في المحاسبة.

## APPROVAL PAGE

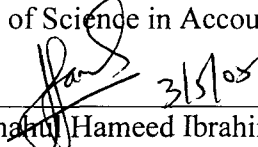
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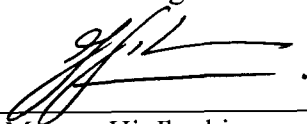
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\_\_\_\_\_  
Unvar Rahman Abdul Mutalib  
Examiner

This thesis was submitted to the Department of Accounting and is accepted as partial fulfillment of the requirement for the degree of Master of Science in Accounting.

  
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Shahid Hameed Ibrahim  
Head Department of Accounting


This thesis was submitted to the Kuliyyah of Economics and Management Science and is accepted as partial fulfillment of the requirement for the degree of Master of Science in Accounting.

  
\_\_\_\_\_  
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## DECLARATION

I hereby declare that this thesis is the result of my own investigations, except where otherwise stated. Other sources are acknowledged by footnotes giving explicit references and a bibliography is appended.

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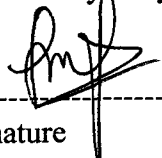
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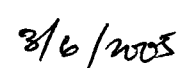
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## CHAPTER 1: INTRODUCTION

### 1.1 The problem

Budgetary slack creation is an act of misrepresenting actual performance capabilities (Douglas and Wier, 2000). Though some researchers suggest that the creation of budgetary slack is common in organizations (Merchant, 1985; Lukka, 1988; Merchant and Manzoni, 1989), and it acts as a tool that is beneficial to buffer against uncertainty particularly in dealing with multiple organizational goals (Lukka, 1988; Stede, 2000; Davila and Wouters, 2004), slack may have negative implications on the organization. For example, it results in the misallocation of a firm's resources, biased performance evaluation and low efforts by managers (Dunk and Nouri, 1998; Douglas and Wier, 2000). Accordingly, slack creation should be limited (Dunk, 1993; Douglas and Wier, 2000; Webb, 2002; Fisher et al., 2000; 2002).

Given the detrimental effects of slack creation, several researchers have attempted to identify the conditions under which it arises and the means by which it may be controlled (Dunk and Perera, 1996; Fisher et al., 2000, 2002; Webb, 2002). More importantly, the researchers discussed these issues from several different perspectives. From the organizational point of view, Lal et al. (1996) replicated Merchant's (1985) studies and found substantial evidence that the administrative systems of organizations influence the propensity of managers to create budgetary slack. From the behavioral perspective, Douglas and Wier (2000) reported that the creation of budgetary slack was affected by the individual's moral philosophy, ethical ideology and ethical position. Lastly, from an ethical viewpoint, the creation of budgetary slack is unethical as it is inconsistent with desirable virtues of professional managers and accountants (Merchant, 1995; Stevens, 2002).



This research aims to replicate prior studies on the determinants of budgetary slack from the organizational and behavioral perspectives. Additionally, it attempts to provide an extension to prior studies by examining how culture, religion and religiosity influence the propensity of managers to create budgetary slack. This is because previous studies reported that culture affects both budget related and dysfunctional behaviors (Ueno and Sekaran, 1992; Chow et al., 1996; Goddard, 1997). As such, culture must also have an influence on the creation of budgetary slack. Additionally, since religion is the core of culture (Faruqi, 1989), and religion preaches virtuous ethics, religion may also have an influence in restraining managers from creating slack in their budgets. However, since the relationship between a religion and an individual's behavior itself is rather complex (Sulaiman, 1998; Weaver and Agle, 2002; Abdul Mutalib et al., 2004), the researcher has limited the scope of the study to how Islam influences Muslim managers in slack creation. More specifically, the research examines if Muslim and non-Muslim managers are indeed, different in their perceptions of slack creation.

## **1.2 Objectives of the study**

The primary objective of this paper is to investigate the determinants of propensity for slack creation from two perspectives: organizational and behavioral. From the organizational perspective, several researchers have argued that the administrative system of an organization influence managers' propensity to create budgetary slack. This includes budgetary emphasis (Stede, 2000; Linn et al., 2001), budgetary participation (Lal et al., 1996; Douglas and Wier, 2000), and the availability of a slack detection system (Lal et al., 1996; Webb, 2002; Stevens, 2002; Fisher et al., 2002). Several researchers (Ueno and Sekaran, 1992; Chow et al., 1996; Tsui, 2001) have

also found evidence of the association between national culture and managerial behavior, and the propensity of managers to create budgetary slack. With regard to the corporate culture, Abas (1999) reported that budgetary slack was also influenced by the quality culture of the organization. Additionally, Dunk and Perera (1997) also argued that the association between budgetary emphasis, information asymmetry and budgetary slack depends upon the personal factor of managers. Accordingly, the second objective of this study examines the influence of culture on the individual's behavior, and subsequently the behavioral perspective of the propensity to create budgetary slack. By replicating some of the hypotheses proposed by previous researchers on a sample of managers in Malaysia, this study will enhance the literature in the area of the influence of culture on budgetary behavior. However, the focus is only on one area of Hofstede's national cultural value, individualism. This is primarily because the prior literature suggested that the propensity of managers to create budgetary slack was influenced by individualism (Ueno and Sekaran, 1992; Tsui, 2001). Additionally, by limiting the scope of the research to only a single company may provide an insight into the importance of corporate culture in explaining budgetary slack behavior.

Finally, the third objective is to investigate the influence of religion on budget slack creation. While prior studies have examined various variables on the propensity to create budgetary slack, none has investigated religion as a possible factor that may influence budget slack. Religions, in general, and Islam, in particular, all preach virtuous ethics. However, Islam does not put a dichotomy between worldly and religious affairs. As such, Islamic teachings influence the behaviors of Muslims (in their worldly affairs) to a greater extent than any other religion. More specifically, the

concept of *maslahah* (the well-being of the *ummah*) will make Muslims refrain from undertaking activities that may harm the community. As such, the opportunistic behavior as reflected in budgetary slack creation is not an activity condoned in Islam. Consequently, one would expect Muslim managers to indulge in less slack creation than their non-Muslim counterparts. Additionally, the study investigates if, indeed, religiosity<sup>1</sup>, influences Muslim managers in their propensity to create budget slack.

### **1.3 Scope of research**

The objectives of the current study were accomplished through a survey of 63 departmental managers of the largest Korean based manufacturing factory in Malaysia. The company was selected for two reasons. First, the company on average, consists of an equal proportion of Muslim and non-Muslim managers. Secondly, a single organization was chosen to control for the variation effects. Otley and Pollanen (2000) suggested that budgeting forms a small part of the wider set of organizational controls. Thus, control practices differ significantly across organizations. As such, it would be appropriate for the researcher to restrict the focus of study to a single organization to control for the variation effects. This approach is likely to increase the chance of an increased understanding of the manner in which variables interact in a specific setting before attempting a more ambitious generalization (Otley and Pollanen, 2000).

### **1.4 Motivation and contributions of research**

Studies on the causes and effects of participative and rigid budgetary styles do not produce consistent findings. This includes their effects towards the propensity of

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<sup>1</sup> Religiosity is measured through the perceptions that working forms a part of '*ibādah* (religious duty) and religion guides an ethical code of conduct.

managers to create budgetary slack (e.g. Linn et al., 2001 and Douglas and Wier, 2000). There are several possible reasons as to why the researchers' findings are somewhat mixed. First, it was potentially due to the various sampling procedures adopted (Lal et al., 1996). Secondly, the samples were both small and diverse (Otley and Pollanen, 2000). Thirdly, the way a variable was used and measured differed across the studies. Finally, most of these studies were conducted in the Western world. Given that these cultural settings may be different from Malaysia, the first motivation of this study is to re-examine the issue of budget slack creation by incorporating all the measures that have been advocated by the previous researchers in a company in Malaysia.

Secondly, the researcher is motivated to extend the previous research by examining the influence of religion on the propensity to create budgetary slack. This could extend the agency theory framework. Webb (2002, p. 376) suggested that another possible area in the issue of slack creation is to extend the agency framework to include factors such as 'fairness, trust and other accountability relationships (that) are also likely to affect behavior in situations where repeated interactions occur between managers and both their superiors and subordinates'. Accordingly, incorporating the Islamic dimension into the model of the propensity to create slack will enable the researcher to investigate the multiple sources of accountability pressures<sup>2</sup> experienced by managers when setting budgets.

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<sup>2</sup> Hameed (2000) suggested that from the Islamic perspective, accountability is two-tiered: accountability to God and accountability amongst men. The latter includes accountability to society and the environment.

### **1.5 Organization of chapters**

The thesis is organized as follows. Chapter 2 reviews the literature on the determinants of budgetary slack. Chapter 3 discusses the literature on the association between culture, religion and the propensity of managers to create budgetary slack. Chapter 4 establishes the theoretical framework. Chapter 5 provides the research design and the development of the questionnaire. Chapter 6 analyzes the results and Chapter 7 discusses the findings. Lastly, Chapter 8 concludes.

## **CHAPTER 2: THE PROPENSITY OF MANAGERS TO CREATE BUDGETARY SLACK**

### **2.1 Introduction**

The purpose of this chapter is to review the literature pertaining to the determinants of budgetary slack from organizational and behavioral perspectives. The structure of the chapter is organized as follows. The next section briefly discusses the use of budgets as a management control system. Section 3 defines budgetary slack from the organizational and behavioral perspectives. Section 4 discusses the determinants of budgetary slack. Additionally, this section examines the association between the propensity to create slack and budget emphasis, budgetary participation, the availability of slack detection and organizational factors. Section 5 discusses the propensity to create budgetary slack from the behavioral perspective. Specifically, budgetary slack contradicts the ethical behavior of managers, thus indicating ethics to be one of the internally mediated controls for the creation of slack (Stevens, 2002). Section 6 concludes.

### **2.2 Budget**

The budget can be considered as an integral part of the management control system (Walker and Johnson, 1999). It is a management technique that compares activity forecasts that have specific objectives or standards with the corresponding achievements (Berland, 2001). The differences between the actual and targeted performance are then compared to evaluate the managerial performance. Therefore, the first stage of the budget helps managers in the aspects of planning including

investment planning and product pricing, while the second stage functions as a performance evaluation and motivation tool (Walker and Johnson, 1999).

The efficiency of budgetary planning, to some extent, depends on the accuracy of the forecasts (Berland, 2001). For instance, Berland (2001) reported that companies that operate in a very unstable environment have implemented strategies that reduce risks and thus, enhance the ability to make accurate forecasts. Otley and Pollanen (2000) also suggested that there are two circumstances in which budgets fail to serve their function: the first is due to the imperfect forecast; and the second is resulted from the divergence between personal and organizational goals (i.e. goal incongruence). Forecasts might be imperfect due to environmental circumstances, the technical inadequacy of the control system, the characteristics of the organization and the way in which members of the organization use the information provided by the system (Walker and Johnson, 1999). As for the goal incongruence, managers may deliberately create slack in the budgets to achieve their own budgetary objectives. As a result, the information provided by the accounting system is invalid, distorted, and biased (Walker and Johnson, 1999).

### **2.2.1 An overview of slack**

Abas (1999, p. 74) described slack as an organizational phenomenon that arises from the tendency of organizations or individuals to not operate at 'peak efficiency'. This concept has been widely discussed over the past few decades from various perspectives including the economic and behavioral aspects as well as in the context of the agency theory.

From the economic point of view, slack is referred to as an 'x-efficiency' (Leibenstein 1966; 1979); a condition where resources are not used to their full capacity or effectiveness, or used in a wasteful manner. In the context of the agency theory, slack exists due to three factors; the presence of information asymmetry, the pursuit of self-interest by the agent, and environmental uncertainty that affects the agent's decision (Choudhury, 1985). Lastly, the organizational behavior literature regards slack in terms of a defensive, tactical and deceptive behavior (Abas, 1999). Such behavior can exist in the communication, decision-making and the presentation of oneself (Schein, 1979). Accordingly, slack is frequently referred to as a negative behavioral phenomenon that arises in certain conditions of the organization, particularly in budget preparation. The next section defines the meaning of budgetary slack.

### **2.3 Budgetary slack**

Budgetary slack is a phenomenon where managers deliberately create forecasts that are relatively easy to achieve (Lukka, 1988). In other words, there is a difference between the subordinates' planned performance targets and real performance capabilities (Young, 1985; Waller, 1988; Chow et al., 1988, 1991, 1996; Douglas and Wier, 2000). In this regard, revenue forecasts might be understated while expenses targets are overstated (Schiff and Lewin, 1970; Dunk, 1993, Fisher et al., 2000).

According to Stede (2000), managers create slack to protect themselves against unforeseen contingencies thus improving the probability that the budget target will be met. Accordingly, it will increase the likelihood of receiving a favorable evaluation and associated performance-dependent rewards. Alternatively, managers create slack to avoid any intervention by upper management such as chances of being fired or