

BUDGET PARTICIPATION AND BUDGETARY SLACK: EVIDENCE FROM QUOTED FIRMS IN NIGERIA

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Abstract

The study examines the effect of allowing subordinate managers and employees to take part in budgeting on budgetary slack creation in Nigeria. Survey research design was adopted for the study. The data used in the study were obtained from questionnaire administered on 800 employees of the 129 firms quoted on the Nigerian Stock Exchange as at September, 2017. Out of the 338 forms retrieved, only 269 (79.58%) were usable. A model was specified and descriptive statistics, correlation analysis, Lagrangian ratio (LR) statistic, factor analysis and ordered logit and probit regression analysis, were carried out. To ensure reliability and validity of the results, diagnostic tests such as normality, multicollinearity and heteroscedasticity were carried out as well. The study reveals that coefficient of budget participation is positive and statistically significant at both 95% and 99% confidence intervals. Thus, among employees of Nigerian firms, budget participation leads to creation of budgetary slack. The paper recommends that management of quoted Nigerian firms should closely monitor employees especially during the budget preparation process to obviate information asymmetry thereby reducing the prospect of budgetary slack creation.

Keywords: Budget participation, Budgetary slack, Information asymmetry, Target, Quoted firms

INTRODUCTION

Individuals, firms and government budgets reflect how financial resources are allocated on the basis of planned activities and short run objectives. Thus, budget serves as a tool for clarifying goals and objectives, communicating, coordinating plans and allocating resources among competing needs. Budgeting is a very important component of planning which together with organizing, staffing, coordinating, implementing, evaluating, and rewarding constitute the key functions of management. Budgets are used for planning and controlling organizations including motivating employees, especially, through participation in the budgeting process.

Budget participation describes a situation where subordinates have influence over what the target should be. But participation in the budgeting process is often associated with behavioural problems which result from communication of inaccurate information to their superiors by employees (Omolehinwa, 2013; Otalor & Oti, 2017). Allowing subordinates to take part in the budgeting process affords them the opportunity to influence decisions concerning expectations of their superiors by creating slack in the budget (Kren, 2003). Budgetary slack refers to a situation where a person

deliberately underestimate his/her capability at the time of preparing the budget in order to make the budget target easily achievable. Budgetary slack has negative impact on the budget process as it provides the potential for a budget to be easily achieved as well as gives a false perception of managers' performance. It defeats the basic purpose of budgets by creating inefficiency and wastage including eroding the quality of comparing actual outputs with budgeted targets (Merchant, 1985; Yuen, 2004).

When subordinates are allowed to take part in the budget, it affords them the avenue of exhibiting opportunistic behaviour by exploiting privileged information to bargain results which further their personal interests, especially when the goals negotiated in the budget form the basis for variable compensation (Otalor & Oti, 2017). This dysfunctional behaviour results in the creation of budgetary slack, thus participation in budgeting tends to discourage employees from disclosing their actual abilities since they can use it to bargain result and ease pressure for achievement of targets (Faria & Silva, 2013). As observed by Leavins, Karim, and Siegel (1997) "managers' perception of the likelihood of participating in the formulation of the budget tends to increase the expectation of being able to inject budgetary slack". Involvement of managers in the budgeting process plays a crucial role in the creation of budget slack. Consequently, the objective of this paper is to examine the impact of budget participation on budgetary slack creation by employees of quoted firms in Nigeria.

While studies such as Maiga and Jacobs (2008), Kren (2003) have shown that budget participation helps to create an opportunity for subordinates to prioritize their interest above organisational goals, other studies (e.g. Faria & Silva (2013); Eker (2008)) find that participation in budgeting results in higher quality decisions, motivates employees to work harder to achieve targets and leads to enhanced information flow between subordinates and superiors.

From the literature reviewed, there is an apparent lack of consensus on the relationship between budget participation and budgetary slack. Moreover, studies conducted in Nigeria such as Ogiedu and Odia (2013) and Ajibolade and Akinniyi (2013) dwelt on the relationship between budget participation and managerial performance, and the influence of organizational culture and budgetary participation on the propensity to create budgetary slack respectively. This study seeks to contribute to existing literature on budget participation and budgetary slack by providing evidence on the likelihood of budgetary slack creation by employees of quoted firms in Nigeria. Consequently, the main research question of this study is about the impact of budget participation on the tendency of employees of Nigerian firms to create budgetary slack.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Employees and managers, as agent, act on behalf of the organization, and as rational beings there is the tendency that they may not always act in the interest of the organization but seek ways to maximize personal goals. This creates agency problem, hence this study rests on the opportunistic behaviour perspective of the agency theory.

Agency theory and budgetary slack

Modern agency theory derives its root from the pioneering work of Berle and Means (1932) on the consequences of separation of ownership from control which results in conflict between the interest of managers and owners of the firm (Manawaduge, 2012). In the views of Leitner (2009: 23) "agency theory points to the important influence of incentives and selfish behaviour of the proponents in organizations and establishes the idea that much of the actions carried out in organizations are motivated by self-interest".

From the Agency Theory perspective, organizational slack is created in the form of budgetary slack as a result of discretionary behaviour which occurs in the agency relationship as a consequence of the existence of bonding and monitoring costs which gives the agent sufficient control over certain resources that can be exploited to satisfy personal preferences at the expense of the organization (Jensen & Meckling, 1976; Leitner, 2009). This is what Williamson (1964) refers to as opportunism. Opportunism is defined as a serious attempt to satisfy individual gains through dishonesty or insincerity in business dealings (Sun & Rath, 2008). Opportunistic behaviour is the result of asymmetric information, with the agent possessing more information than the principal (Bradshaw, Richardson, & Sloan, 2001).

The origin of budget and budgeting

While the principles of budgeting were derived from the budgeting techniques in government, Hofstede (1968) reports that in Europe, the use of budget for business derives from the works of Henri Fayol (1841- 1925), but it was Thomas Bata (1876-1925) who initiated the use of departmental profit-and-loss control as a measure for managing his decentralized firm (an international shoe company which was split into federating unit of small businesses operated independently) that popularized the idea of budgeting. In the views of Hope and Fraser (1997), the quest to ease the complexities of managing more than one strategy and engender rapid growth as products and market expanded led multidivisional organizations like Dupont, General Motors, Siemens, Saint Gobain and Eléctricitéde France to adopt the use of budget in the 1920s. The diversity in product markets necessitated new systems and measures for decentralized operations. Consequently, budgets and return on investment measures became ready tools for the evaluation of the divisions and motivation of managers including proper allocation of resources among divisions (Banovic, 2005; Johnson & Kaplan, 1991).

Another source of budgeting principles which was the dominant practices among United States (US) industries between 1911 and 1935 was the scientific management movement. Thus, to all intents and purposes, the budgeting system in the US is an offshoot of Fredrick Taylor's Scientific Management Movement (1911-1935) — an idea that explains the management of firms from the shop floor through the length and breadth of the organization.

Budgetary Slack

The concept of organizational slack introduced into accounting literature in the 1930s is the harbinger of studies on budgetary slack (Banovic, 2005; Barnard, 1938). Budgetary slack has been defined in several ways. Young (1985, p.831), defines budgetary slack “as the amount by which a subordinate underestimate his/ her productive capability when given a chance to select a work standard against which his/her performance will be evaluated”. Budgetary slack has also been defined as the intentional underestimation of revenues and productive capabilities and/or overestimation of costs and resources needed for the completion of a proposed task (Dunk & Nouri, 1998). Steven (2002) defines budgetary slack as the amount by which a subordinate underestimate his productive capability at the time of preparing the budget/estimates against which his performance will be measured. Budgetary slack is created when a subordinate understates their capabilities (by overestimating costs and underestimating revenue) or the capabilities of a business unit in their budget (Hobson, Mellon, & Stevens, 2011). Budgetary slack is the difference (excess/shortfall) between the budgeted resources and the resources required for the efficient attainment of the goals of the organization (Kilfoyle & Richardson, 2011). Otor (2017) defines budgetary slack as the intentional biasing of performance targets by subordinates below their expected levels and capabilities during budget proposal section in order to make budgeted targets more easily achievable.

Budget participation and Budgetary slack

Budget participation is a process which entails the active involvement of subordinates and superiors in the determination of budget targets. Budget participation has been defined as “the process whereby the superior selects the form of the compensation contract and the subordinate is permitted to select specific value for each parameter in the contract” (Young, 1985, p.830). Mah'd, Al-Khadash, Idris and Ramadan (2013, p.135) defines budget participation “as a means of communicating and influencing managers in the budgetary process, and as the extent of subordinate influence over setting budgetary targets”. Budgetary slack is created by managers who are able to conceal some private information from their supervisors and deliberately misrepresent that information in order to maximize their own benefit through the introduction of slack (Damrongsukniwat, Kunpanitchakit, & Durongwatana, 2013). When managers perceive that they are likely to take part in the formulation of the budget, the perception tends to increase the expectation of being able to inject budgetary slack (Leavins, Karim, & Siegel, 1997).

Swieringa and Moncur (1972) and Benke and O'Keefe (1980) show that in a highly participative budgetary systems, the opportunities for the injection of budget slack abounds. Similarly, Onsi (1975) opines that the greater the degree of participation of managers in the budgetary process, the greater the opportunity for managers to influence resource allocation resulting in budgetary slack creation. Dunk (1993) finds a relationship between budget participation and slack but opines that the relationship depends upon the levels of budget emphasis and information asymmetry. He further asserted that the existence of budget slack may be influenced by the extent of budget participation and that budgetary slack may be connected to degree of budget participation. Leavins, Karim and Siegel (1997) conducted a research to establish the sources of budgetary slack creation by sending a total of 307 copies of questionnaires to departmental managers in some companies seeking to ascertain the respondents' perception on budget slack. The result indicates that modern companies provide ample opportunity and scope for management to create and maintain considerable budgetary slack to satisfy personal objectives. They thus, find that budget participation, the level of decentralization, and the use of budget in organisation' reward system increases budget slack.

Kren (2003) reports that participating in the budget process and control systems leads to creation of budget slack. Maiga and Jacobs (2007) who used data collected from a survey of 163 managers in the United States of America and structural equation modeling, investigated the influence of participants on budget slack. The result of the study shows that budget participation impacts both procedural fairness and distributive justice and these in turn affects trust. Moreover, they found that fairness and trust have significant impact on budget goal commitment which influences the propensity to create slack in a negative manner. Bradshaw, Hills, Hunt and Khanna (2007) investigated whether budgetary slack can be used as a risk management strategy in New Zealand's new public management (NPM) control setting, and examined how successful the reforms are, after more than 20 years of adoption. They concluded that budget slack still has the potential to exist within the NPM of New Zealand. This was implicated for four independent variables: high accruals, revenue growth, ministry size, and ministry stability. However, the study failed to recommend any measure to reduce budgetary slack. Similarly, Ajibolade and Akinniyi (2013) conduct a study to ascertain the association between budgetary participation, organisational culture and the propensity for holders to create budgetary slack through data obtained from 272 budget holders in ten Nigerian Universities. The result shows that participation in budgeting has some mediating effect on the relationship between organisational culture and the creation of slack. These researchers conclude that measures aimed at using budget participation to reduce budgetary slack in public sector organisations may not yield the desired result, but did not suggest what can be done to reduce budgetary slack in public sector organisations.

But the participation in the budgeting process does not adequately explain slack because it is necessary that the slack is not known to superiors such that the manager can establish a reserve and protect himself from an unsatisfactory performance evaluation, prioritizing his own interests over that of the organisation. (Dechow & Shakespeare, 2009; Junqueira, Oyadomari & Moraes, 2010; Libby, 2003). According to Stevens (2000) management may not be able to detect the level of slack in the budget due to subordinates' private information (asymmetry) regarding local operating conditions. Damrongsukniwat, et al. (2013) find that the propensity of budgetary slack creation is inversely related to the extent of participation allowed in the budgeting process possibly due to positive communication between superiors and subordinates. Consequently, the relationship between budget participation and budgetary slack is hypothesized as follows:

Hypothesis 1: There is no significant relationship between budget participation by employees of Nigerian quoted firms and tendency to create budgetary slack.

METHODOLOGY

The population of the study consists of the employees of 129 out of the 177 firms quoted on the Nigerian Stock Exchange as at September, 2017. The sample was drawn from the firms in all the sectors except Construction and Real Estate, ICT, Oil and Gas which the study believes may find it difficult to set target for individual employee or manager in view of the nature of the products or services offered which cannot be easily moved from one place to another but can only be marketed pictorially. In view of the difficulty in reaching all members of the population of interest or sampling frame, a subset of the population was determined using the table developed by Krejcie and Morgan (1970) based on the following formula for an infinite population is given as:

$$n = \{Z^2 \times p(1 - p)\} / M^2 \dots\dots\dots (3.1)$$

Where:

- n = Sample size for infinite population
- Z = Z value (e.g. 1.96 for 95% confidence level)
- P = population proportion (expressed as decimal) (assumed to be 0.5 (50%))
- M = Margin of Error at 5% (0.05)

As the study was unable to determine the exact number of employees of the selected firms, the study adopted the formula for infinite population which gives a sample size of 400 and since the researchers in their judgement expected a 50% response rate, 800 questionnaire were distributed to the respondents in person and through e-mail addresses for those we could not reach in person. A total of 338 questionnaire (representing 42.25% response rate) were retrieved, out of which 269 (representing 79.58%) were found usable.

Primary data were used in the study. The data were extracted from the responses to the administered instrument. The questions relating to the variables of study: budgetary slack creation and budget participation were designed on a seven-point Likert scale of strongly agree to strongly disagree and factor analysis was employed to determine the validity and reliability of the test items. This method used by Presslee (2013) was adopted to give the respondents a wider range of choice.

The specified model was estimated using a qualitative response (the ordered logit and probit) model due to the qualitative nature of the data used in the study. The ordered logit and probit model built around the latent regression similar to the binomial probit model (Greene, 2003; Greene & Hensher, 2008, 2010) is given as:

$$Y_i^* = \hat{\alpha}'X_i + \hat{\alpha}_i, i = 1, \dots, n \text{ ----- (3.2)}$$

The residual diagnostic test carried out include: (i) Normality test (ii) test for Multicollinearity, and (ii) test for heteroscedasticity.

Model Specification and Operationalization of Variables

The model used in this study is specified as follows:

$$\text{BUDSLACK} = (\text{BUDPART}) \text{ ----- (3.3)}$$

Where:

BUDSLACK= Budgetary slack creation

BUDPART= Budget Participation

The functional form of the model is given as follows:

$$\text{BUDSLACK} = \hat{\alpha}_0 + \hat{\alpha}_1 \text{BUDPART} + \hat{\alpha}_t$$

RESULTS AND DISCUSSION

Validity and Reliability

Table 4.1 presents the result of the factor analysis for test items measuring the creation of budgetary slack and budget participation.

Table 4. 1

Validity and reliability of measurement

Variable	T	\bar{e}^2	BUDSLACK	\bar{e}	T	\bar{e}^2	BUDPART	\bar{e}
Statistic:								
	2	0.924		0.961	6		0.731	0.829
	1	0.911		0.954	2		0.692	0.824
	3	0.308		0.555	5		0.861	0.893
					4		0.771	0.599
					1		0.406	0.518
					3		0.859	0.903
Cronbach's alpha		0.67(0.657)					0.62(0.584)	
Eigen value		2.210					2.343 1.155	1.038
KMO		0.549					0.557	
Bartlett's test:								
χ^2		909.61					259.747	
$\chi^2 - p$		0.0000					0.0000	

Source: Researchers' computation (2017) from IBM SPSS Statistics 23. "T" are the test items.

From table 4.1, it can be seen that all test items for the dependent variables loaded highly with \bar{e} of 0.961, 0.954 and 0.555 and eigen value of 2.210 indicating that the items are practically significant. The factor explains between 92, 91 and 31 percent of the variation {communality (\bar{e}^2)} in the distribution of test items. Kaiser-Meyer-Olkin (KMO) value of 0.549 shows that the sample size is adequate, while the unstandardized Cronbach-Alpha of 0.657 confirms the reliability of test items or the existence of internal consistency. Similarly, the test items measuring budget participation loaded highly with test items 6 and 2 loading on factor 1 as 0.829 and 0.824 respectively, test items 5, 4 and 1 loaded on factor 2 as 0.893, 0.599 and 0.518 respectively, while test item 3 loaded highly on factor 3 as 0.903. Factor 1 explains between 73 and 69 percent of the variation {communality (\bar{e}^2)} in the distribution of items. In the same vein, Factor 2 explains of 86, 77 and 41 percent of the variation in the distribution of the items, while factor 3 explains 90 percent of the variation in the distribution of test item 3. While the Kaiser-Meyer-Olkin (KMO) value of 0.557 shows that the sample size is adequate, the unstandardized Cronbach-Alpha of 0.584 confirms the existence of internal consistency.

Regression Diagnostic tests

In line with the ordinary least square (OLS) regression assumptions, we tested for normality, heteroscedasticity, and multicollinearity. The result of the diagnostic test in Table 2 shows that both the dependent and independent variables are normally distributed as follows: BUDSLACK = 9.61 (0.008); and BPART = 28.30 (0.000). The multicollinearity test reveals that there is no problem of collinearity as the regressor has variance inflation factor (VIF) of 1.11 which is less than 10. Similarly, both the

Bruesch-Pagan-Godfrey and the Ramsey's RESET indicate that there is no problem of heteroscedasticity as the probability of the F- statistic and observed R-squares in both are greater than 5% ($p > 0.05$)

Table 2
Diagnostic test for the regression results

Variable	Normality	Heteroskedasticity	Multicollinearity Centered VIF
	J-B Statistic		
		Bruesch-Pagan-Godfrey	
C	NA		NA
BUDSLACK	9.61(0.008)	F= 1.753 (F12,255); Prob. = 0.056 Obs*R2 = 20.43; Prob chi (12)= 0.056	-
BUDPART	28.30(0.000)	Ramsey's RESET F= 3.286 , Prob F(12,255) = 0.07 t = 1.83; Prob (255)= 0.07	1.11

Source: Researchers' computation (2017) from E-view 9.5.

REGRESSION RESULTS AND DISCUSSION OF RESULTS

Three approaches are used for the estimation of the censored model. The main statistics of interest for the ordered estimation are the coefficient estimates and their corresponding significance. The choice of the best model to interpret is based on the LR value with the smallest probability for each of the reports. However, in this study we interpreted the result of all three estimates.

Budget participation and Budgetary slack

Table 3 shows that a significant positive relationship exists between budgetary slack creation and budget participation. The coefficient of BUDPART is 0.516, 0.92 and 0.637 for the probit, logit and extreme values; z-value = 6.05($p=0.0000$); 5.83($p=0.0000$) and 5.86($p=0.0000$) respectively. The implication of this result is that allowing subordinates to take part in the budgeting process leads to budgetary slack creation. The finding is in tandem with the conclusions of Ajibolade and Akinniyi (2013); Bradshaw, et al., (2007); Dunk (1993);Kren (2003);Leavins, Karim and Siegel(1997) and Maiga and Jacob (2007); but negates the finding of Damrongsukniwat, Kunpanitchakit, and Durongwatana (2013) who report a negative relationship between budget participation and budgetary slack creation.

Table 3
Estimation Resultsfor Model) BUDSLACK and BUDPART

Variable	Probit			Logit			Extreme value		
	Coef.	z-Stat.	Prob.	Coef.	z-Stat.	Prob.	Coef.	z-Stat.	Prob.
BUDPART	0.516	6.05	0.0000	0.92	5.83	0.0000	0.637	5.86	0.0000
Pseudo R-squared		0.06			0.07			0.08	
LR statistic		118.91	0.000		110.12	0.000		126.42	0.000

Source: Researchers' computation (2017) from IBM SPSS Statistics 23.

The estimated latent values (Y^*) indicates the tendency of each respondent to create budgetary slack. Although, the study interpreted the result of the probit, logit and extreme values, the threshold test focused on the probit estimates only as the result for the other estimates are similar. Considering the threshold limits (not reported here), none of latent values for the observations is lower than both the lowest threshold value of -12.63 and the highest threshold value of -7.80. Thus, from the estimated model, all the respondents exhibited high tendency to create slack in their budgets. This implies that when employees in Nigeria firms are allowed to participate in the preparation of budget targets, they tend to create slack in the budget to make the budget easily achievable.

FINDINGS , CONCLUSION AND RECOMMENDATIONS

Budgetary slack commonly called budget biasing constitutes a crucial component of the behavioural dimension of budgeting which has been widely researched in view of the pervasive influence of budgeting on individuals, firms and government. Budget participation which results in the exhibition of opportunistic tendencies affords employees the chance of exploiting privileged information to satisfy personal interest at the expense of organisational goals. This requires carefulness on the part of private and public sector organizations that would want to allow their employees take part in the budget preparation exercise.

The finding of this study indicates that budget participation by managers, supervisors and employees of listed firms in Nigeria has a positive impact on budgetary slack creation suggesting that employees of quoted firms have a high prospect of building slack into the budget in order to make the budget more easily achievable. In fact the estimated latent values reveal that all the respondents exhibited tendency to create slack in their budget. The study believes that monitoring employees at the point of preparing the budget may help obviate the possibility of creating slack and therefore recommends that management of quoted Nigerian firms should closely monitor employees to reduce budgetary slack creation which results from information asymmetry.

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QUESTIONNAIRE

TOPIC: BUDGET PARTICIPATION AND BUDGETARY SLACK: EVIDENCE FROM QUOTED FIRMS IN NIGERIA

SECTION I: RESPONDENT BIODATA

1. Age (a) 25-40 years [], (b) 41-50 years [], (c) 51 years and above [].
2. Sex: (a) Male [], (b) Female [].
3. Academic Discipline: (a) Sciences [], (b) Social Sciences [], (c) Art [], (d) Humanities [].
4. Educational Qualification: (a) HND [], (b) B. Sc and others [].
5. Job Experience: (a) 10-15 years [], (b) 16-25 years [], (c) 26-30 years [], (d) 31 years and above [].
6. Official Status: (a) Senior staff [], (b) Management staff [], (c) MD/Chief Executive [].
7. Place of work: _____
8. Are you involved in the budgeting process? YES/NO: If YES, proceed to Section II; if NO, go to item no 9
9. Is target set for you or your unit/department/branch? YES/NO: If YES, proceed to Section II; If NO, **STOP** and return the questionnaire.

SECTION II

Please tick as appropriate. NB: **SA** stands for strongly agree, **MOA** for Moderately Agree, **MIA** for mildly agree **N** stands for Neutral, **MID** for Mildly Disagree and **MOD** for Moderately Disagree and **SD** for Strongly Disagree

Budget Participation

1. I am involved in setting my unit/departmental/branch budget or targets. SA [], MOA [], MIA [], N [], MID [], MOD [], SD []
2. My contribution to the budget is very important. SA [], MOA [], MIA [], N [], MID [], MOD [], SD []
3. My superior initiates frequent budget discussions when the budget is being prepared. SA [], MOA [], MIA [], N [], MID [], MOD [], SD []
4. My superiors and I frequently discuss budget-related issues initiated by me. SA [], MOA [], MIA [], N [], MID [], MOD [], SD []
5. I have considerable influence over my unit/departmental/branch final budget. SA [], MOA [], MIA [], N [], MID [], MOD [], SD []
6. My superior clearly explains budget revision to me. SA [], MOA [], MIA [], N [], MID [], MOD [], SD []

Creation of slack

1. Managers in my organization tend to submit budget which can be easily achieved. SA [], MOA [], MIA [], N [], MID [], MOD [], SD []
2. Slack in the budget is good so that things can be done that cannot be officially approved. SA [], MOA [], MIA [], N [], MID [], MOD [], SD []
3. Department managers tend to influence their evaluations by adjusting the figures submitted in the budget. SA [], MOA [], MIA [], N [], MID [], MOD [], SD []