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(AIJBES)**www.aijbbs.com**A REVIEW OF BUDGETARY SLACK FROM THE CORPORATE
GOVERNANCE PERSPECTIVES**Jia Bin^{1,2*}, Noorul Azwin Md Nasir¹, Zaminor Zamzamin¹, Amira Jamil¹¹ Faculty of Entrepreneurship and Business, Universiti Malaysia Kelantan, Malaysia

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DOI: 10.35631/AIJBS.622015This work is licensed under [CC BY 4.0](https://creativecommons.org/licenses/by/4.0/)**Abstract:**

Existing research and practice have found that budget management does not work as expected, and some problems incompatible with firm development are gradually exposed, budgetary slack being one of them. Using the research method of literature review, this paper identifies the determinants of budgetary slack from the perspective of corporate governance as: executive remuneration, executive risk appetite, independent directors and director expertise, respectively, which fills the gap between the influence of executive characteristics and board characteristics on budgetary slack. Studying the determinants of budgetary slack can help firms improve the quality of budget management, optimise internal control and enhance the quality of corporate governance.

Keywords:

Budgetary Slack, Executive Remuneration, Executive Risk Appetite, Independent Directors, Directors' Expertise, Corporate Governance

Introduction

Good budget management is the beginning of improving the quality of corporate governance, and the core focus of modernised corporate governance has been gradually tilted towards budget management, which is an important strategic and management tool that can enhance the efficiency of resource allocation and performance of firms (An, Zhao, & Shen, 2018).

However, some studies have found that budget management does not work as expected, and budgetary slack may be an obstacle in budget management (Tang, 2020). Robey (2019) found that firms often fail to obtain an optimal return on investment by following established budget goals, this is because when managers are faced with the temptation of compensation benefits, they lower their moral level and almost all managers will deliberately hide private information and submit untrue budget targets (Li, 2021). Budgetary slack arises when there is a discrepancy between the prepared budgetary objectives and the real objectives (Dunk & Nouri, 1998). Budgetary slack can cause a decline in the efficiency of resource allocation, breed financial fraud, and more seriously, cause a waste of firm resources and a decline in performance (Sun & Peng, 2019), leading to abnormal corporate governance (An & Ai, 2022).

The purpose of this paper is to sort out the determinants that influence budgetary slack from the perspective of corporate governance. Budget management is an important strategic and corporate governance tool in the corporate governance process, where executives are the strategy makers and implementers of budget management, and the board of directors is empowered to participate in monitoring the budget behavior of executives. Therefore, executive characteristics and board characteristics may be determinants that influence budgetary slack, specifically, this study sorts out executive remuneration, executive risk appetite, independent directors and director's expertise as determinants that influence budgetary slack. Compared with previous studies, this paper innovatively combines executive characteristics and board characteristics, expanding the perspective and depth of research on budgetary slack.

Overview of Budgetary Slack

Definition and Prevalence of Budgetary Slack

Scholars at home and abroad have carried out more research on budgetary slack and achieved richer research results in the definition and prevalence of budgetary slack.

In the 1960s, Cyert and March (1963), when researching some firms in the United States, found that the management would reduce the budget target through negotiation and consultation and other measures in the process of budgeting, so that the budgeted sales target was lower than the real sales target, which was the first time that the budgetary slack phenomenon was found in a firm. Merchant (1985) from the perspective of the theory of organizational behavior to study the American electronics industry budget management problems, and will be budgetary slack defined as: the completion of a project, more than the necessary resources of the excess resources. Dunk and Nouri (1998) that the budgetary slack refers to the completion of a certain budget task, intentionally underestimated revenues or production capacity, overestimated the cost of the behavior or resources.

Choiriah (2019) studied budgetary slack in firms using survey methodology and concluded that almost all firms have budgetary slack. Liu (2019) studied the budget management of private firms on the main boards of China's Shanghai and Shenzhen markets, showing that most managers submit unrealistic budget targets and that budgetary slack is common in Chinese firms. Farrell et al. (2021) similarly demonstrated through a multi-round simulation experiment that budgetary slack is prevalent in firms and that those responsible for the budget frequently create budgetary slack throughout the budget as a game of chance between them and their bosses.

Impact of Budgetary Slack

Scholars at home and abroad hold different attitudes towards budgetary slack, which can be summarized into two main categories. One believes that budgetary slack is harmful, which is also the mainstream view at present. Another believes that budgetary slack is beneficial.

The vast majority of scholars believe that budgetary slack is harmful. Made and Agung (2018) based on the principal-agent theory and contingency theory on the budget management of rural banks in Bali found that budgetary slack undermines the planning, controlling, and scheduling functions of budget management, and reduces the competitiveness of banks. An, Zhao, and Yi (2019) analyzed the current situation of budget management in Chinese firms from the perspective of principal-agent theory, and concluded that budgetary slack leads to the inversion of executive remuneration and firm performance, and many firms have seen a decline in performance while executive remuneration continues to increase. Sun and Peng (2020) investigated the economic consequences of budgetary slack from the perspectives of audit risk and information distortion, and the empirical results found that budgetary slack is positively associated with cost demands and unreasonable resource demands. Afdhal, Rahayu and Ardi (2021) found that when budget targets are linked to performance-based pay, those responsible for budgets have incentives to create budgetary slack because they can get high pay by manipulating budgetary slack. Budgetary slack is an opportunistic behavior that puts individual pay interests above organizational interests, and its existence leads to disorganized firm management and a decline in the level of firm governance (Christensson & Forslund, 2022).

A few scholars have argued that budgetary slack is beneficial. Schatzberg and Stevens (2008) argued that budgetary slack promotes subordinates' motivation and effort because the cushioning effect of budgetary slack makes them feel secure and stable. An and Ai (2022) found that budgetary slack also promotes the firm's ability to innovate to a certain extent. Allowing the preparation of appropriate budgetary slack is beneficial in that it can motivate employees to be fully creative (Zhang, 2018).

Determinants of Budgetary Slack

Previous scholars have argued that factors such as budget pressures, budget communication and conflicts of interest cause budgetary slack problems.

In terms of budget pressures, Mitchell et al. (2018) argued that the weaker the manager's resilience to stress, the more likely he/she is to create budgetary slack, and the probability of budgetary slack arising increases when budget emphasis is imposed on the manager. This may be due to pressure from superiors that lowers the ethical standards of employees (Br & Khoirunisa, 2021). A person's attitude, personality traits, psychology and self-perception may influence his behavior and this behavior can predict their willingness to create budgetary slack (Liu, Ye, & Dong, 2019).

Second, for budget communication factors, Kristianto & Apriliya (2023) argued that the efficiency of budget communication decreases when information asymmetry is fostered within the firm, and management creates budgetary slack by taking advantage of the information. The impact of budgetary slack is positively and significantly influenced by the empirical results of Wang (2021), which show that environmental uncertainty leads to poor information communication channels within the firm. Both formal and informal budget communication can

significantly and negatively influence budgetary slack, and strengthening budget communication is conducive to reducing budgetary slack (Jiang, Wu, Dai, & Shen, 2022).

Finally, other scholars have examined the relationship between conflict of interest factors budgetary slack. Afdhal, Rahayu and Ardi (2021) interviewed 102 budget holders and found that these holders have a greater tendency to be opportunistic and create budgetary slack by placing their personal remuneration interests above organizational interests. In a principal-agent relationship, management more often works for private gain rather than shareholders' interests, and this opportunistic behavior is also known as rent-seeking behavior, and the essence of budgetary slack lies in management's rent-seeking behavior (Zhang, 2019). In order to seek a larger space for private gains, management will take the initiative to reduce the difficulty of the budget target and create budgetary slack, which in turn prevents capital from being efficiently allocated (Wang, 2021).

Existing literature has mainly studied the causes of budgetary slack from individual behavioral or psychological perspectives such as budget pressure, budget communication and conflict of interest, which is a single cause without combining different factors, and the study may not be in-depth enough. Because the comprehensive budget management of an company is based on the behavior of the organization as a whole and the budget holders (executives), organizations have different structures and institutions, and executives have different personalities and experiences, whose habits and tendencies influence the choices of budget behaviors of the company (Wang, 2022). Executives are the main makers and executors of budget management and may harm the overall interests of the organization for their personal interests, therefore, organizations can appoint professionals to supervise the budget behaviors of executives by setting up a board of directors (Wang, 2019). Next, this paper will attempt to sort out the determinants influencing current budgetary slack from executive characteristics and board characteristics.

Executive Characteristics

Executive Remuneration

Chang (2015) argued that executive remuneration is the remuneration that executives receive for ceding the right to use their personal labor or human capital to the firm, and that this individual factor influences corporate governance. The findings of Ajid et al. (2021) suggest that executive remuneration promotes firm profitability. Wijeweera, Rampling, and Eddie (2022) demonstrated that long term incentive pay contributes significantly to executive motivation and firm performance.

However, as rational economic beings, executives may use their power or influence to manipulate performance and engage in rent-seeking behavior when remuneration is lower than the desired target (Jensen & Murphy, 1990). Sivanandan and wahab (2020) confirmed that the previous year's firm performance positively influences the current year's level of executive remuneration, which in turn, in turn, contributes to the firm's governance capacity. According to principal-agent theory, executives will be forced to manipulate performance in order to improve their remuneration levels and enhance corporate governance capabilities, and the performance-remuneration inversion scandals resulting from this opportunistic behavior have seriously damaged the image of the firm (Dewi, Putrayasa, & Suarjana, 2020).

When manipulating performance can frequently lead to high remuneration, management may take advantage of professional and informational advantages to put their personal interests above the firm (Li, 2022). Huang (2020) argues that if an important condition for managers to receive compensation is to fulfil budget targets, they may reduce the difficulty of budgeting and increase the probability of fulfilling budget targets by underestimating future revenues, overestimating costs, and so on. probability, obtaining higher remuneration rewards and good budget credibility, which generates budgetary slack. According to principal-agent theory, managers have private information that shareholders are not aware of, which facilitates the creation of budgetary slack (An, Zhao, & Shen, 2018; Li, 2021). Therefore, this study concludes that executive remuneration is a determinant of budgetary slack.

Executive risk appetite

Risk appetite is an attitudinal choice and psychological trait that is related to the individual, and people of different ages make different decisions with different levels of acceptance of reward or loss (Wang, 2022). Jing (2021) argued that risk appetite is closely related to an individual's personality traits and work environment, it is the focus of behavioral economics research and has been widely borrowed from various research fields, different decision makers are willing to take different levels of risk for the same project with the same return, and make different business decisions. Arslan et al. (2020) found that executives are more concerned with common and known risks and carry this risk appetite into their work.

Behavioral theory suggests that in the long run, managers with high risk appetite prefer to make strategic decisions with higher goals and managers with low risk appetite make conservative decisions (Burkhard et al., 2023). In the short run, risk appetite is associated with budget goals, and high risk appetite tends to prepare higher budget goals (Willebrands, Lammers, & Hartog, 2012), potentially slowing down budgetary slack. Risk averse managers set generally lower budget targets to avoid falling into risk (Taki & Soroushyar, 2023), creating a greater probability of budgetary slack.

Vanini and Rieg (2021) argued that the risk attitude of executives directly influences the financial budgeting behavior of firms. Risk averse executives are more focused on what they are good at, which leads to the possibility that they may miss some good investment opportunities, which results in underinvestment and reduces the value of the firm (Ho, Huang, Lin & Yen, 2016). However, venture enthusiasts are more likely to seize good investment opportunities, set higher budget goals and enhance firm performance (Willebrands, Lammers & Hartog, 2012). Wang and Sun (2023) argue that there is a positive correlation between executive risk appetite and firm innovation activities. Science, technology and innovation (STI) activities inhibit the probability of budgetary slack occurring because the large number of STI activities motivates managers to actively compress budgetary slack when setting budget goals (Chi, 2019). Therefore, this study concludes that executive risk appetite is a determinant of budgetary slack.

The influence of executive characteristics on budgetary slack is summarized in the table 1.

Table 1: The Influence Of Executive Characteristics On Budgetary Slack

Determinants		Key Views
Executive Characteristics	Executive Remuneration	<ol style="list-style-type: none"> 1. Improving firm profitability; 2. Promoting corporate governance capabilities; 3. Manipulation of budget targets for rent-seeking behavior; 4. Performance-remuneration inversion; 5. Placing personal interests above the firm; 6. Facilitates the creation of budgetary slack
Executive Characteristics	Executive Risk Appetite	<ol style="list-style-type: none"> 1. Relates to individual personality traits; 2. Influences the firm's strategic decisions; 3. Influences firm budgetary behavior; 4. High risk appetites tend to prepare higher budget targets; 5. Risk averse individuals prepare more conservative budget targets;

Source: Author's collation

Board Characteristics

Independent directors

Agents, as rational economic beings, and principals naturally have principal-agent conflicts, and in this context, in order to mitigate agency conflicts and monitor the opportunistic behavior of executives, principals (shareholders) can solve such problems by appointing independent directors (Aluchna, Mahadeo, & Kamiński, 2020). The board of directors, elected by the general meeting of shareholders, bridges the principal-agent relationship. A more independent board of directors can significantly monitor the self-interested behavior of executives and reduce the probability of budgetary slack. This shows that the board of directors, as an important mechanism of corporate governance, also has a greater influence on budget management (Wu & Dong, 2021). Kapoor and Goel (2019) similarly found that diligent independent directors play a positive role in monitoring executives, earnings management.

Tang (2020) argues that budgetary slack is a form of ex ante financial fraud, and that the more diverse the board's personnel structure, the more independent it is, and that strong independent directors can reduce the incidence of financial fraud. Independent directors can monitor executives' performance of their duties, reduce opportunistic tendencies and improve the quality of corporate governance (Fogel, Ma, & Morck 2021). Independent directors have strong control over the board's involvement in strategic decision making compared to executive directors. Therefore, when board members are independent from the management of the firm, they can monitor the management in a good and important way, improve the quality of corporate disclosure and reduce financial fraud (Zaid, Abuhijleh, & Pucheta-Martínez, 2020).

Neville, Byron, Post, and Ward (2019) argued that increasing the proportion of independent directors on the board of directors can curb corporate misbehavior, improve the quality of management and reduce financial fraud. Kapoor and Goel (2019) used Indian listed firms as a sample of research and constructed panel data, the results show that independent directors can curb firm surplus management and mitigate executive fraud against shareholders in a principal-agent context. Larger independent directors can effectively monitor managers, limiting their ability to manipulate earnings management and reducing their opportunistic behavior (Saona,

Muro, & Alvarado, 2020). This implies that the greater the independence of independent directors, the lower the budgetary slack. Therefore, this study identifies independent directors as a determining factor in influencing budgetary slack.

Director's expertise

Under the principal-agent framework, the board of directors is a key corporate governance mechanism to protect the interests of shareholders and the firm (Masulis & Zhang, 2019). Experts with a professional background in finance serving as board members can identify financial reporting problems in a timely manner, effectively restrain opportunistic behavior of insiders, and ensure the quality of financial management (Yao, Wang, & Lv, 2018). Boards with high financial ratios send a signal to the outside world that they are professional, focused and efficient, and that they are capable of dealing with various resource allocation issues in the firm and safeguarding shareholders' interests (Ali, Rehman, Sarwar, Shoukat, & Farooq, 2022).

Previous studies have shown that directors with accounting backgrounds have stronger ex-ante, ex-ante and ex-post supervisory functions over management's hollowing out behavior, which helps to improve the quality of the corporate management decisions and reduce financial risks (Wang, Wu, & Xu, 2016). Masud, Bae, Manzanares, and Kim (2019) found a significant positive correlation between the accounting expertise of the directors and the firm's corruption disclosure (CCD) have a significant positive correlation. Alcaide Ruiz (2022) investigated the influence of directors' financial expertise on firms' decision-making, and panel data confirmed that accounting directors improve the quality of disclosure in firms' financial statements and firms are more financially forward-looking. This may be due to the fact that only board members have sufficient expertise to understand, predict and address risks.

Ali, Rehman, Sarwar, Shoukat, and Farooq (2022) argued that firms with financial directors are more capable of dealing with budgetary management and allocative efficiency than other firms. This is because directors' expertise aids management in decision making while guarding against their opportunistic tendencies (Nawaz, 2022). Liu (2022) argues that directors educated in finance-related professions can make firms more capable of dealing with a wide range of financial risks, such as budgetary slack, in complex and diverse business environments. Qiao, Chen and Hung (2018) test proved that the accounting expertise of directors can enhance the internal supervision of firms, guard against insider self-interested behaviors, and has an unparalleled ability to improve the firms' governance quality and the quality of budget management is unrivalled. Therefore, this study concludes that directors' expertise is a determinant of budgetary slack.

The influence of Board characteristics on budgetary slack is summarized in the table 2.

Table2: The Influence Of Board Characteristics On Budgetary Slack

Determinants		Key Views
Board Characteristics	Independent Directors	1. Mitigating agency conflicts and monitoring opportunistic behavior of executives;
		2. Is a bridge between the principal-agent relationship and reduces budgetary slack;
		3. Improves the quality of corporate governance and reduces financial fraud;
		4. Curbing firm surplus management and mitigating executive fraud against shareholders

Board Characteristics	Director's Expertise	1. Is a key corporate governance mechanism;
		2. Disciplines opportunistic behavior of insiders and ensures the quality of budget management;
		3. Reinforcing resource allocation and safeguarding shareholders' interests;
		4. Improving the quality of firm management decisions and reducing financial risk;
		5. Ability to cope with budgetary slack

Source: Author's collation

Conceptual Framework

In this paper, the determinants of budgetary slack are sorted out based on the corporate governance perspective, specifically from executive characteristics and board characteristics, executive remuneration, executive risk appetite, independent directors and directors' expertise are the determinants of budgetary slack. Based on the above explanation, the conceptual framework of this paper can be summarized as shown in Figure 1 below:

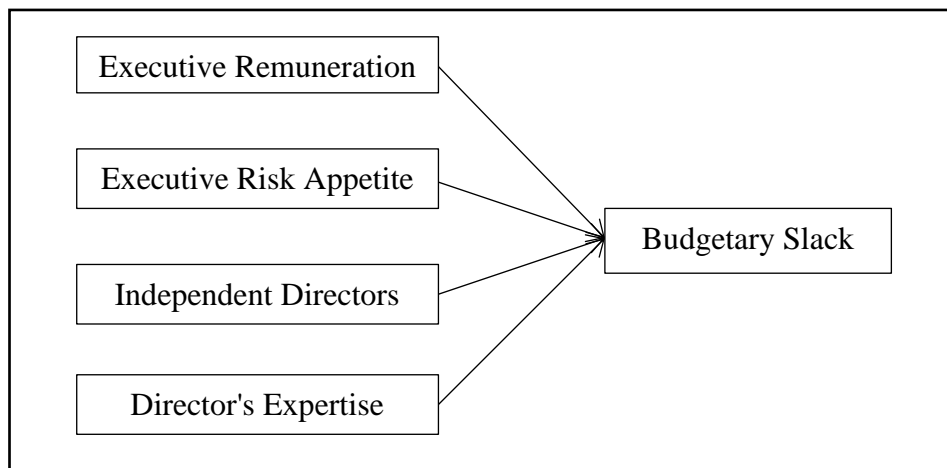


Figure 1: Conceptual Framework In The Study

Source: Author's illustration

Conclusion and Discussion

A review of the literature reveals that budgetary slack is a kind of ex ante financial fraud, which seriously hampers the effective performance of budget management and leads to inefficient allocation of corporate budget resources, and in the long run, budget management becomes a sham and the quality of corporate governance is seriously degraded. In contrast to previous findings, this paper, after combing the literature, argues that budgetary slack is due to the superposition of executive and board characteristics, specifically, executive remuneration, executive risk appetite, independent directors and directors' expertise are the determinants of budgetary slack.

The firm should improve their executive remuneration systems by abandoning the system of linking executive remuneration to budget targets and linking executive remuneration to the firm's performance and that of its peers. This is because once executive remuneration and budget targets are linked, executives are likely to prepare budget targets that are easier to achieve in order to obtain remuneration incentives, thus leading to budgetary slack. In addition,

the firm should establish a risk appetite assessment mechanism, optimize the selection process of executives, and when hiring executives, not only should they be examined in terms of their professionalism, academic qualifications and work experience, but also should carefully collate their past experience, analyze the risk appetite characteristics of executives, and screen out the senior management personnel who are in line with the development stage of the company or its current needs, so as to give full play to the maximum effect of budget management.

The firm should strictly implement the independent director system, make independent directors an important measure of corporate governance, increase the proportion of independent directors and their voice, and avoid selecting and hiring 'busy' and 'friendly' independent directors who are unable to fulfil their duties as directors. When appointing directors, the firm should increase the proportion of directors with financial expertise and, as far as possible, make a reasonable mix of theoretical and practical accounting types to give full play to their respective strengths. Increasing the proportion of independent directors and appointing directors with financial expertise can assist executives in making correct strategic decisions on the one hand, and monitor opportunistic behavior by executives on the other, reducing the probability of budgetary slack.

Although this paper broadens the scope of factors influencing budget slack by including executive characteristics and board characteristics and budgetary slack in the same research framework, which opens up a new direction for researching the issue of determinants of budgetary slack, it has not yet empirically verified the specific relationship between them. Therefore, future research will analyze the specific influence mechanisms of executive remuneration, executive risk appetite, independent directors and directors' expertise on budgetary slack from a quantitative point of view, and propose multidimensional strategies to govern budgetary slack.

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