

*Research Article*

## The Pattern of Budget Slack in Sharia Microfinance Institutions: A Phenomenology Study

Solihah<sup>1</sup>, Frida Fanani Rohma<sup>2\*</sup>

<sup>1,2</sup> Faculty of Economics and Business, Universitas Trunojoyo Madura

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### Abstract

This study explores budgetary slack in Islamic ultra microfinance institutions, specifically examining the role of religious affiliation. Using a qualitative phenomenological approach, data was collected through interviews at an Islamic Savings and Loans Financing Cooperative. The findings reveal a disparity between theoretical and practical perspectives on budgetary slack. An imbalance between targets and compensation drives actors to rationalize budgetary slack, exacerbated by information asymmetry. Religious affiliation primarily impacts business products and services but has little effect on subordinate behavior. Contrary to assumptions that budgetary slack is unlikely in Sharia-compliant systems, this study suggests that the Sharia institutional environment may still foster budgetary slack due to opportunistic behavior. This research is among the first to examine budgetary slack in Sharia microfinance institutions, highlighting the potential for such behavior even within religiously guided systems.

Keywords: Budgetary slack, religious affiliation, ultra micro, justice, rationalization

JEL Classification: D22, H61, M41

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Corresponding author: Frida Fanani Rohma ([frida.frohma@trunojoyo.ac.id](mailto:frida.frohma@trunojoyo.ac.id))



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### 1. Introduction

Budgetary slack is an activity to reduce the target from the best estimate that individuals have to optimize their personal interests (Rohma & Anita, 2024, Maiga & Jacobs, 2007, Stevens, 2002, Rohma et al., 2023). Grediani & Sugiri (2010) explained that subordinates tend to propose budgets by lowering revenues and increasing costs compared to the best estimates that have been proposed so that targets will be more easily achieved. This is in line with stream of research that budgetary slack has a great potential to harm the company because it has an impact on decreasing profitability and increasing long-term costs (Kung et al., 2013, Gago-Rodríguez & Naranjo-Gil, 2016, Rohma 2022). The magnitude of the potential for future losses that occur causes research on budgetary slack cannot be ignored both in terms of causal factors and mitigation efforts.

Stream of research show that several factors that trigger budgetary slack include information asymmetry (Brahmayanti & Sholihin, 2006, Murtin & Septiadi, 2012), career uncertainty (Widanaputra & Mimba, 2014) budget pressure (Irfan et al., 2016) and several other contextual aspects. Meanwhile, other research developments have succeeded in exploring efforts to mitigate budgetary slack, including budget participation (Arifin & Pagalung, 2018, Dunk, 1993, Pundarika & A.A.N.B, 2018, Onsi, 1973), slack detection (Anita & Rohma, 2020) organizational commitment (Nouri & Dunk, 1998, De Baerdemaeker & Bruggeman, 2015) satisfaction (Kahar et al., 2016) and several other factors.

Thus, this study seeks to explore the pattern of budgetary slack that occurs in ultra-micro businesses that are specifically sharia-based. This also answers the development of research showing that religiosity can mitigate fraudulent acts (Suhendi et al., 2020, Hayati & Amalia, 2021, Purnamasari & Amaliah, 2015, Eslampanah et al., 2017, Said et al., 2018). The existence of a religiosity base formed in sharia-based ultra-micro businesses makes it not take action against budgetary slack, or has the same pattern of slack as other entities or has a pattern of budgetary slack that is different from others, requiring further study. However, the development of research specifically only examines from the perspective of large-scale organizations and corporations. There is still limited research that examines specifically the phenomenon of budgetary slack that occurs in micro and ultra micro scale businesses. Meanwhile, the role of micro and ultra micro scale businesses cannot be ignored. This is because the two business scales have proven to be able to survive and make a significant contribution to the economy when faced with problems of economic stability.

This research involves a branch of a sharia savings and loan cooperative in East Java. The research indicate that there are different meanings of perspective that make actors in sharia-based ultra micro institutions assess that budgetary slack is an action that does not deviate from sharia. The imbalance between the targets set and the compensation given causes the emergence of a low perspective of distributive justice which is the main trigger for rationalization of subordinate at the research site. This research contributes to three main streams. First contribution, empirically this research complements research studies that have largely ignored the role of micro and ultra micro-scale institutions. Second contribution, theoretically the research explores the perspective of religious affiliation attached to the values and sharia principles used in institutions. The stream of research so far tends to explore from the perspective of religious commitment and does not consider the role of religious affiliation which views a person as being part of a particular group of organizations or religious institutions. Third contribution, practical contribution for the management and business managers at the sharia micro and ultra micro level in making decisions, budget targets and control mechanisms.

The structure of writing this article includes, in part two, it includes a literature review of the subject of research, in part three it discusses research methods. Part four, examines the results of the research and discussion. Meanwhile, in part five is conclusions, limitations and suggestions.

## 2. Literature Review

### *Budgetary Slack*

Budgetary slack is an action in which individuals tend to focus on budget targets that require the least amount of effort and are possible to achieve (Rohma & Chamalinda, 2023, Gago-Rodríguez & Naranjo-Gil, 2016). Budgetary slack has the potential to benefit lower-level management or subsidiaries or branches of the company and to the detriment of their top-level managers or parent or corporate headquarters. This can happen because the action of slack has the potential to reduce profits due to the proposed budget target being lower than the actual target that should be met. Based on the perspective of agency theory, budgetary slack can occur due to information asymmetry between subordinates (agents) and superiors (principals) (Rohma & Novitasari, 2023, Chow et al., 1988, Fisher et al., 2002, Merchant, 1985). The agent has more information than the principal. This makes the principal unable to monitor the actual ability or

potential of the agent. Thus, specifically this research will explore from the perspective of the principal, namely the subsidiary business branch to comprehensively capture the phenomenon of budgetary slack.

In accounting perspective, budgetary slack has harmful consequences for future profits or future costs. In addition, budgetary slack can cause resource losses due to non-optimal budget targets set (Rohma, 2022, Kung et al., 2013, Gago-Rodríguez & Naranjo-Gil, 2016, Huang & Chen, 2010). Therefore, the impact of budgetary slack that has the potential to harm businesses cannot be ignored and needs to be investigated. Some researchers use the agency perspective to explain the existence or occurrence of budgetary slack (Young, 1985, Chow et al., 1988, Fisher et al., 2002, Merchant, 1985). The findings of this study indicate that agents tend to ignore business interests and prioritize personal interests. The research potential in the behavioral domain can still be expanded in various contexts. This study elaborates on the role of religious affiliation as a sharia business identity in filtering budgetary slack. Konteks senjangan anggaran pada penelitian ini yaitu perbedaan antara usulan target anggaran dan kemampuan aktual capaian target yang dilakukan oleh anak perusahaan terhadap induk perusahaan dari situs penelitian. Situs penelitian yang utama yang dilibatkan pada penelitian ini yaitu anak perusahaan dari Islamic Savings and Loans Financing Cooperative karena sistem penganggaran yang dilakukan menggunakan kombinasi top-down dan button up, sehingga aktivitas usulan dapat tercermin dari usulan target anak cabang kepada induk perusahaan.

***Asymmetric Information*** In an organization of course requires communication to convey information from one party to another. Submission of such information often reflects inequality in the delivery of information because one party has more information than the other, this is known as information asymmetry. According to Dian et al (2016) Information asymmetry is an imbalance of information held by superiors and subordinates. Information asymmetry occurs when subordinates have more information than superiors about an organizational unit (Rohma et al., 2023, Rohma, 2023). This happens because subordinates are directly related to the operational activities of the organizational unit so that they will have different information from their superiors (principle). Information asymmetry related to determining the right budget is indeed not easy and will be a problem if subordinates have better information than superiors. The difference in information held between superiors and subordinates is called information asymmetry. As explained by Dunk, (1993) and Kusufi et al (2020) explain that information asymmetry occurs because there is a party (agent) who has more information than the other party, which in this case means the principal.

Furthermore, the authors conclude that information asymmetry occurs due to an imbalance of information held by superiors (principals) and subordinates (agents) because one party has superior information. And those who have the advantage of the information are more directly related to the operational activities of the organization. This difference can be an opportunity for the agent to take action beyond the knowledge of the superior (principle).

### 3. Data and Method

#### ***Research Type***

This research using a qualitative method with interpretive paradigm. Moleong (2013) and Rohma et al (2023) explain that qualitative intends to understand the phenomenon of what is experienced by the research subject, such as behavior, perception, motivation, action holistically. This research uses a qualitative approach to capture budgetary phenomena and behavior in more depth. Moreover, there is still limited research on slack in sharia ultramicro organizations. Thus, a qualitative approach provides a more powerful ability to carry out initial studies of potential budgetary slack models in sharia ultramicro organizations that require sharia contracts within them. This study uses an interpretive paradigm. The interpretive paradigm in many ways is also referred to as the constructive paradigm, which emphasizes that research is basically done to understand the reality of the world as it is (Djasuli, 2017). Understanding social reality as it is is shaped by the awareness and actions of a person looking for the meaning

behind something, so that the participatory aspect of the actors in social activities takes precedence. The approach used in this research is a single holistic case study approach as described by Yin (2012). The holistic single case only examines the general nature of the program in question. In line with what was stated (Yin, 2012) this study focuses on a single holistic case that examines the general nature of the implementation of activities and budgeting mechanisms and is carried out at the research site.

#### ***Research Sites and informants***

This research site is one of the ultra-micro financial institutions engaged in the Sharia Financing Savings and Loans Cooperative. Specifically, the selected business institution is a subsidiary. This is because the subsidiary theoretically acts as an agent that has great potential to make budgetary slack. Specifically, sharia-based businesses were chosen to draw a more holistic meaning and analysis of the role of religious affiliation in framing individual work behavior.

This study involved several key informants to obtain relevant and adequate information regarding work behavior patterns and activities. (Moleong, 2013) asserts that an informant must have a lot of experience about the research setting. The number of informants' experiences can help the researcher achieve the objectives to obtain the overall information from the entire activity and then detail each of the existing uniqueness of the information obtained. Unstructured interviews were conducted with 8 key informants, including the head of the branch, the administration section, the teller section, the financing section, the LASISMA section, the savings section and 2 savings clerk employees. In addition, field observations and documentation are carried out to obtain relevant data and information.

#### ***Triangulation Techniques***

In order to increase the degree of trust or validity of the data, this research uses triangulation techniques. (Moleong, 2013) describes that triangulation is a technique of checking the validity of data that utilizes something else. Outside the data for checking purposes or as a comparison against the data. The triangulation technique used in this study is source triangulation, which means comparing and checking back the degree of trustworthiness of information obtained through different times and tools in qualitative research (Moleong, 2013). The source triangulation is achieved by comparing the data from observations made by researchers with data from interviews with informants in the study. Another thing is to compare what people say in public with what people attribute privately.

### **4. Results**

The ultra-micro sharia financial institution “Z” is engaged in the field of sharia financing savings and loan cooperatives. This institution has several products offered to its customers and partners, including savings, financing, service products and mall products. The results of the observations show that there is an observation mechanism through a system that is carried out between the agent (Business Unit), and the principal (holding company). This is as conveyed by the branch office that in general the head office knows that all performance is recorded through the BMT\_Z application so that every incoming and outgoing money transaction can be known by the head office as the principal.

Interestingly, the observations show that although there is a system that facilitates business control mechanisms. However, there are still some information asymmetries that the agent deliberately hides. As stated by the informant:

*“One of them is the branch office’s strategy to find customers/partners. For this reason, the head office does provide this responsibility without any standard rules. For example, from the LASISMA product, our branch office deliberately closed the LASISMA financing application because it prevents the budget target from increasing in the next perio”.*

The information requires that the agent deliberately takes advantage of the loophole provided by the principal to carry out the practice of reducing the budget target. This is confirmed by other informants who corroborate with statements.

*“Actually, this is related to the budget target that must be achieved by each employee. In “Lembaga Z” East Java has its own budget target that must be achieved in the period. so every office needs to develop a strategy to keep meeting the targets that have been set.”*

The statement implicitly explains that individuals intentionally take advantage of loopholes to avoid activities as a strategy to minimize targets. More than that, specifically the information from some of these informants shows that the deviation effort was not carried out personally. However, it is carried out in collusion which is seen as a strategy in groups. The results also show that agents tend to carry out information asymmetry because there is a tendency to increase budget targets because there are provisions for increasing budget targets regularly every year. Even the observations show that basically the head office as the principal has tried to control it by using bonus-based compensation. However, some individuals and in general branch offices as agents tend not to try to optimize bonuses. This is because of the concern that the target will periodically increase. However, what is interesting is that the actors in these ultra micro business institutions do not realize that the behavior that is carried out is conceptually a deviation. This was conveyed in the statement of one actor, namely:

*“We, KSPPS Z employees, believe that there was no misappropriation of the nominal amount of money that we reported. There is also a control team that detects irregularities by visiting the branch office every month by evaluating all administrative completeness that ensures the accuracy of transactions with the reported nominal.”*

The research findings indicate that the bonus-based compensation scheme is not optimal enough as one of the control mechanisms implemented at the research site. This finding is in line with the findings (Purnama, 2015) which also explains that economic-based compensation schemes alone are not effective enough to motivate individuals. The existence of different risk preferences for each individual and the existence of different levels of love for economic compensation cannot be ignored. Individuals tend to have different risk preferences. Individuals with a high risk preference are likely to perceive target setting as having a high risk weight rather than the economic compensation obtained. In accordance with what has been conveyed by one of the informants at KSPPS Z:

*“Of course, every company has its own strategy to meet these targets in order to get bonus compensation. However, there are also companies that do not really pursue the existing targets, because of concerns that the targets will continue to increase in the next period.”*

Findings on the research indicate that individuals are more likely to avoid compensation offered by the holding company in order to avoid potentially greater risks. This finding is in line with the perspective of myopic loss aversion (Atsala, 2017) that individuals tend to avoid the benefits that will be obtained in the short term to avoid the risks that will be faced. This finding is also in line with several studies such as Hati (2011) which explains that individuals tend to avoid certain economic benefits to avoid potential risks that are considered to be greater. Compensation contracts between principals and agents can also affect accounting conservatism. Where conservatism is defined as management action by anticipating no profit more and recognizing losses more quickly even though the possibility of profit is said to be large (Watts, 2003).

The research findings show that the potential for budgetary slack cannot be separated even though individuals are at the ultra-micro business level. However, it is interesting that the actors do not realize that their behavior is a form of budgetary slack. The actors interpret these actions as actions that do not deviate. Because the action is a proper action because the target is too high. This finding is in line with the argument of the fraud triangle theory Sari & Safitri, (2019) that the tendency of fraud committed by individuals is triggered by opportunities, pressures and rationalizations. The

actors have the opportunity to make budgetary slack because of the position they have in terms of the structure and authority of the position. The actors feel pressure because a target that is too big is the main trigger for slack. The actors try to rationalize the actions taken and assess it as a reasonable action because it is considered to have been used to happen. As stated by one of the actors in the ultra micro business. This is also in line with the explanations of Nahartyo et al., (2020) ) that individuals who have rationalized will tend to rationalize even their rationalization will be much greater.

This indicates that the potential for budgetary slack can occur at all levels and types of business. Although the business base developed is a business based on a sharia perspective, the potential for slack can still occur. The sharia perspective used is only limited to the basis for each type of product that is given. This has no impact on individual behavior (the actors in it). This is in accordance with (Yustina & Gudono, 2017) explanation that basically every individual is a rational economic man. The principle of rational economic man is still running even though the individual is in certain environmental conditions.

Research findings also indicate the potential for information asymmetry by employees. This is captured through information that shows there is a difference in the information submitted regarding the application for lasisma which is closed by the research site. This was deliberately done as a strategy to avoid target spikes in the next period. The information was deliberately not conveyed by the research site (subsidiary) to the head office.

The findings of the study indicate that the research site tends to exhibit risk aversion behavior. This is in line with the explanation of Belkaoui (2002) and Merchant & Stede (2017) that individuals tend to prefer direct performance-based rewards that come from businesses that are not influenced by uncontrollable factors such as economic factors and competition, to Force majeure. Various findings include when the internal controls that have been implemented in an agency have not been able to guarantee the absence of individual fraud in it, there are still other considerations such as myopic loss aversion, or rationalization of the fraud that occurred in the agency. So this study predicts that there is a potential budgetary slack in KSPPS Z.

## 5. Conclusion

The findings of this study indicate that the budgetary slack occurs at the organizational level even though the organization is part of a sharia business. This indicates that religious affiliation only has implications for the products and services provided. However, not on the behavioral aspects of the actors in it. Potential budgetary slack can be triggered by weak control mechanisms. Moreover, the potential for budgetary slack occurs due to excessive rationalization of the actions taken. The occurrence of information asymmetry that occurs is considered as something natural through the process of rationalization that occurs due to activities that have been carried out repeatedly.

There are some limitations of this research. First, specifically, this research only pays attention to one side of the subsidiary organization. Not paying attention to the holding company. This is because the greatest potential for organizational slack occurs from the parent to the child level. Second, the research only examines according to the observations obtained without considering the individual characteristics of each actor being interviewed. Third, this research only focuses on one of the service products offered which is considered the most potential among other service products. This is done so that the analysis can be carried out in depth and comprehensively. Thus, further research can specifically consider a two-sided perspective, namely from the level of the subsidiary and the holding company. Moreover, further research can consider and pay more attention to the personal characteristics of each research actor that may potentially have an impact on the information and arguments given. In addition, further research can examine more comprehensively in terms of all products, services or all master budget activities in general.

## Recommendation

Recommendations for further research in the realm of budgeting are that the potential for budgetary slack can occur in all industries, including those based on sharia contracts. Sharia financial institutions that comply with Islamic rules still have the potential to incur budgetary slack due to the personal behavior patterns of individuals in the organization. Thus, research can expand by examining the determinants of budgetary slack in sharia organizations which can be integrated with the organization's existing management control system. More than that, for business regulations and management. It is necessary to pay attention to ideal targets to minimize potential budgetary slack. More than that, the elaboration of ideal sharia contracts is needed not only for products offered to consumers/customers. However, it is also very necessary to develop an organizational management control system based on sharia values in order to minimize the potential for long-term dysfunctional behavior that could harm the organization.

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