

## The Influence of Culture on the Relationship Between Level of Participation Budgeting and Firm Performance in the Context of Libya

<sup>1</sup>Yosef kalefa Hosen, <sup>2</sup>Wee Shu Hui, <sup>2</sup>Suzana Suliman and <sup>2</sup>Ibrahim Abdul Rahman

<sup>1</sup>Faculty of Accountancy, University Technology Mara (UITM), Malaysia

<sup>2</sup>Faculty of Accountancy UITM, Malaysia

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**Abstract:** In this paper we explore the influence of national culture dimensions on the level of participation budgeting and firm performance in the context of Libya, following the changes in economic policy in Libya. A survey questionnaire was employed to collect the data for this study, for data analysis SEM was used to analyze the data by AMOS 18. Our results suggests that national culture elements within Libyan manufacturing companies found to be high power distance, high masculinity, slightly high in uncertainty avoidance and collectivism element. The level of participation in budgeting is low. That is meaning there is an influence of culture on the level of participation in budgeting and the use of MCS within Libyan firms. The study focuses on a sample of managers of small and medium-sized manufacturing firms; therefore the findings cannot be generalised to other sectors. The paper is one of the few studies attempting to assess the effects of culture on the level of participation budgeting in the transitional economy countries.

**Key words:** Participation budgeting • Small and Medium Firms • Societal Culture

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### INTRODUCTION

A budgeting system is one of the oldest instruments of a management control system. Both large and small organizations use budgets to plan their business ahead to get an idea of what the future will bring and also to review the situation to know how carry out future plans. Planning and budgeting systems increase the amount of management control in organizations because they encourage long-term thinking, achieve coordination and create challenging but realistic goals.

Participative budgeting-usually defined in the accounting literature as a process in which a manager is involved with, and has influence on, the determination of his or her budget-has been one of the most researched topics in management accounting for over 40 Years [1]

The relationship between budget participation and performance has a long history in the managerial accounting literature [1-5] Shields and Shields [6] three studies that found direct positive relationships between budget participation and performance [7]. In a path analysis study, Chenhall and Brownell [8], failed to find evidence of a direct effect. Frucot and Shearon [5] find mixed results on this relationship. Tsui [9] suggested that

the interaction effects of MAS and budgetary participation on managerial performance were different, depending on the cultural background of the managers.

This paper explores the relationship between participation budgeting and firm performance during post-privatization period and the influence the culture on this relationship.

**Libyan Industrial Companies:** Libya is located in North Africa and has a long coast on the Mediterranean Sea, it is Arabic speaking country and citizens are predominantly Muslims. Libyan industrial companies like those in many other developing countries, are owned, managed and supervised by government institutions [10]. Libyan products must be competitive both in quality and price in order to succeed in the world market.

The transition in Libya from a planned economy to a market economy, which commenced in the late 1980s, has resulted in fundamental changes such as the restructuring of state-owned enterprises, a noticeable growth in foreign direct investment and an emerging private sector. These changes put immediate pressure on accounting practices to change to meet the demands of the new business environment.

In an attempt to rehabilitate the factories and in order to boost their productivity, the state has intervened by privatizing all the factories at the first stage of the privatization programme, transferring ownership of factories to the existing workforce and management. As a result, many problems and difficulties have emerged, including: (i) most of the former managers carrying on their duties in the same way as before; [11] some of the workforce after becoming the owners of the factories, still thinking at the same style in public sector, reflecting their lack of understanding of the privatization process; [11] inadequate capital for running the privatized factories; (iv) the privatized factories were still operated as part of the public sector, especially during the first five years following privatization (for instance, total dependency on the state for obtaining foreign currency to buy raw materials and other equipment); and finally, excess unsold stock was accumulating as a result of the lack of efficient marketing policies [12-15].

Libya has undergone a transformation from a centralized economy to a market economy, in 2003 Libyan government started the first stage of this programme (privatization) with the SMEs. In this paper we explore the influence of national culture dimensions on the level of participation budgeting in the context of Libya, following the changes in economic policy in Libya.

**Literature Review and Hypothesis Development**  
**Theoretical Taxonomies of National Culture and Participation Budgeting:** Hofstede [16] defines the culture of a nation (national culture) as “ *the programming of the mind that is manifested in the values and beliefs of a society*”. Values are reflected in an individual’s preferences for certain states of affairs. Hofstede identified four work-related values or national culture dimensions that differ systematically across nations: power distance, individualism collectivism, masculinity-femininity and uncertainty avoidance. Subsequent research reported by Hofstede [17], identified a fifth national cultural dimension, namely, Confucian dynamism.

Hofstede’s framework was based on the assumption that people around the globe are guided and driven by different attitudes, beliefs, morals, customs and ethical standards. Societies have different traditions, religions and rituals and have different views dealing with family issues, work matters, social occasions and their personal responsibilities [18]. Hofstede [19] addressed five dimensions on national culture values:

**Low Vs. High Power Distance:** Power distance measures how much the less powerful members of institutions and organizations accept the fact that power and wealth are distributed unequally. Low vs. high power distance measures the way people accept and perceive power differences.

**Individualism Vs. Collectivism:** This dimension measures whether people prefer to work alone or in groups and how much members of the society define themselves apart from their group membership. In an individualistic society, members mainly look after their own and their immediate family member’s interests and they are expected to develop and display their individual personalities and to choose their own affiliations.

**Masculinity Vs. Femininity:** This dimension measures the value placed on traditionally male or female values, it measures the degree of difference in the social role between different genders. In masculine culture, people value competitiveness, assertiveness, ambition and the accumulation of wealth and material possessions. In this type of dimension, female members tend to care for the non-materialistic needs, while male members are expected to obtain materialistic needs. In feminine culture, people value relationships and quality of life. Collectivistic societies tend to have more masculinity present, in which the difference in social role in gender are more distinctive.

**Low Vs. High Uncertainty Avoidance:** Uncertainty avoidance dimension measures how much members of a society attempt to cope with anxiety by minimizing uncertainty. It refers to the way in which people will deal with the future, whether they have inherent control or whether events are beyond their control. A society with low uncertainty avoidance will require structure and order with clear rules and guidance, those societies tends to be more risk taking, more tolerant to changes and more aggressive. A society with high uncertainty avoidance tends to be more security-seeking, intolerant to changes and less aggressive.

National culture dimensions have been used in cross-cultural studies in accounting [5, 20, 21]. Harrison [22] examined the effects of national culture on the level of decentralization of responsibility.

Following Hofstede and Bond [17] examination of national culture in international business, Chow, Harrison, McKinnon and Wu [23] and Hui [24], studied the effects of national culture on all performance measurement and

evaluation in manufacturing firms. However, national culture has not been examined in the use of management accounting information in SMEs.

Participation can occur at both the planning and performance evaluation stage of the budget cycle. Participative budgeting refers to the extent to which subordinates have inputs into the development and selection of the performance plan, which the superiors will hold them responsible for achieving. The reactions to participation in planning can be predicted across various nations if one can measure the relevant cultural characteristic [22].

The relevance of Power distance to budget participation is based on the argument that as [25] notes, in high Power distance countries, subordinates have strong dependence needs and expect superiors to behave autocratically and not to consult them. Consequently, the act of allowing a subordinate to be involved in budgeting matters would be seen as counter to authoritative leadership because leaders are expected to lead and shoulder the responsibility [26]. Here, such perception would generate anxiety amongst employees in a country where submission to authority figures is ingrained in the culture [27].

This perception is likely to render participation ineffective and to cause subordinates to question their superiors' legitimacy and competency and thus would be a source of reduced trust and respect for their superiors. Conversely, in low power distance culture societies, subordinates will prefer a more participative consultative style of management. This perception is likely to increase the effectiveness of budget participation since it will be seen as a legitimate management style, in approving such a style, subordinates will see his/her superior as competent and trustworthy.

Therefore in low *power distance* societies, because of vertical equality between people in the firms, employees prefer or expect to be involved with or have input into their organization's decision-making process including determining their budget. In contrast, in high power distance cultures, since superiors are expected to unilaterally make decisions about subordinates, less use of participative budgeting would be expected. In other words, high power distance is associated with low participative budgeting and low power distance is associated with high participative budgeting.

*Individualism* is also relevant to participative budgeting, as societies higher in this national culture dimension prefer to have more influence over their actions. In other words, high individualism is associated

with high participative budgeting and low individualism is associated with low participative budgeting. Ueno and Sekaran [28], suggested that, an individualistic society such as the U.S., more formal communication and coordination processes may have to be resorted to than in a collectivistic society, such as Japan.

Hofstede [16], provides evidence that in a high power distance, people believe that employees lose respect for a consultative manager. Also Child [27], contends that, while an involvement of subordinates in discussions of problems might be seen as an appropriate supervisory style by most American workers, it could be regarded as a sign of poor leadership and hence generates anxiety by employees in country where submission to authority figures is ingrained in the culture.

A preference for non-consultative, decisive leadership style in high power distance is also likely to produce a preference for high reliance on accounting performance measures as an evaluation style. So, it can be predicted that subordinates in high power distance societies will prefer a high reliance on rigid accounting performance measures style of evaluation, and not prefer participative evaluation style, this is because of the consistency of this evaluation style with the cultural expectations and dictates of hierarchical relationships in that society.

For the individualism national culture dimension and its impact on preference for acceptance or refuse of reliance on accounting performance measures as management control tool. Individualistic societies believe in the uniqueness of each person while collectivistic societies believe in the homogeneity and comparability of people. Harrison, [29], notes that, by contrast with people in individualistic societies, people of collectivistic societies are especially concerned with comparison with others. The issue of comparability is important to whether high or low reliance on accounting performance measures is seen as appropriate in different cultures, this is because high reliance on that measure itself is based on the assumption that individuals are comparable. Where a high reliance on these measures as an evaluative style assumes people can be compared on their ability to meet budget and does not take account of person-specific and situation-specific factors relevant to performance. This will be inconsistent with the belief in the uniqueness of the individual maintained in individualistic societies. In these societies, such an evaluative method will be seen as forcing a standardisation on individuals and denying the individual's right to a person-specific evaluation.

As the person-specific evaluation will react from low reliance on accounting performance measures evaluative style, subordinates in high individualism societies will prefer such a style (participative performance evaluation) and will view and react to a high reliance on accounting performance measures evaluative style in negative manner [29]. By contrast, the assumption of comparability is consistent with the belief in the homogeneity of people in collectivist societies.

The concern with comparisons with others is accommodated by the issue of standardised and quantified measures associated with high reliance on accounting performance measures. Such an evaluative style will be preferred by subordinates in collectivistic societies and subordinates reaction to increasing reliance on accounting performance measures will be favourable [29].

Thus, the expectations of the influence of culture on the preference for reliance on accounting performance measures as a management control tool will be the same for low power distance and individualism on one hand and for high power distance and collectivism (Low individualism) on other hand. In other words, high individualistic societies will prefer high participative performance evaluation and low individualistic societies will prefer low participative performance evaluation. Also high power distance will be associated with low participative performance evaluation and low power distance will be associated with high participative performance evaluation.

Considering the relevance of uncertainty avoidance to reliance on accounting performance measures as an evaluative style, uncertainty avoidance has two theoretical attributes, tolerance for ambiguity and uncertainty, and attribute to risk. A high uncertainty avoidance society is one in which there is a low tolerance for ambiguity and uncertainty and an aversion to risk taking [16].

Taking the "tolerance for ambiguity component", it may be argued that high reliance on accounting performance measures, as an evaluative style may be perceived as appropriate in a high uncertainty avoidance society, because high reliance on these measures provides greater certainty and less ambiguity about the performance level required to obtain a favourable evaluation. However, taking the "attitude to risk component", the reverse expectation arises.

Hofstede [16], notes that the aversion to individual risk in high uncertainty avoidance societies means that people in these societies prefer group decisions,

Table 1: relationship between participation budgeting and culture

Management control system	Relevant national culture dimensions	Source
Participation budgeting	Individualism (+)	Harrison [20]
	Collectivism (-)	O'Connor [26]
	High Power distance (-)	Chow [4]

consultative management and believe that subordinates should be able to influence superiors decisions. These are all characteristics of low reliance on accounting performance measures and would allow the argument that low reliance on accounting performance measures would be perceived as appropriate in a high uncertainty society.

Those two theoretical components of uncertainty avoidance give rise to internally inconsistent and contradictory expectations, and hence uncertainty avoidance is not implicated in our study regarding its effect as national cultural dimension on the design of and preference for reliance on accounting performance measure as an evaluative style or management control tool.

For masculinity national culture dimension, which is concerned with the ways in which biological difference between the sexes become perpetuated in difference in social and organisational roles played by men and women, no literature exists nor does any theory suggest itself to expect this dimension to influence the preference for reliance on accounting performance measures as management control tool.

*H1a. There is negative relationship between high power distance culture and the level of participation in budgeting.*

*H1b. There is negative relationship between high individualism culture and the level of participation in budgeting.*

*H1c. There is negative relationship between high masculinity culture and the level of participation in budgeting.*

*H1d. There is negative relationship between high uncertainty avoidance culture and the level of participation in budgeting.*

**Participation Budgeting and Performance:** Refer to the extent to which subordinates have input into the development and selection of the performance plan which their superiors will hold them responsible for achieving [4].

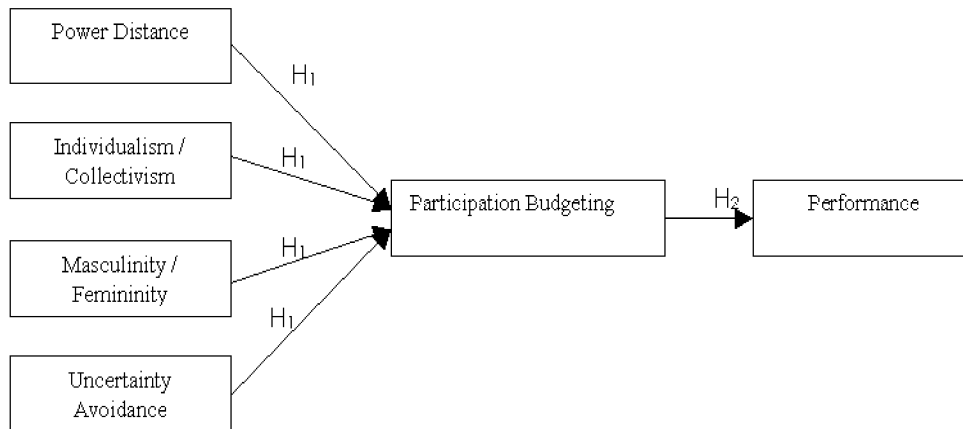


Fig. 1: Hypothesis Model

Tsui [9] suggested that the interaction effects of MAS and budgetary participation on managerial performance were different, depending on the cultural background of the managers. These results have implications for the design of effective control subsystems and suggest that the management accounting theories developed in the context of Western economies may not be generalizable to the Chinese environment.

Etemadi *et al.* [30] investigated the impact of culture dimensions (individualism, power distance, uncertainty avoidance and masculinity) on management accounting and managerial performance. The results indicate that management accounting tools and techniques, which improve managerial performance in one organization may have a dysfunctional impact in another organization with a different cultural background.

A better understanding of different cultures could assist managers to participate and deal more effectively with employees in a suitable way while undertaking the budgeting process.

**H2.** *There is no relationship between the level of participation in budgeting and firm performance.*

**Methodology:** A survey questionnaire was employed to collect the data for this study, The questionnaire was originally produced in English, which is not an official language in Libya and is not widely spoken in the business sectors. Therefore, it was decided to translate the questionnaire into Arabic, the official language in Libya, to make it very clear for the respondents.

The survey instrument includes a copy of the questionnaire and letter explaining the purpose of the study, a tear-off section allowing respondents to provide their name and address in order that they may be sent a

copy of the survey results while ensuring anonymity, both the questionnaire and the letter of request were presented in the Arabic language.

**Population and Sample Selection:** The population of this study is defined as all managers in medium small and manufacturing privatized companies in Libya, which have been privatized in the first stage of Libyan privatization programme.

The sample selected for this study was initially defined as all managers those have tenure (experience) in current firm at least 10 years. The reason for this was that those how have tenure less than 10 years would not be able to answer the majority of the questions since most of questions specifically related to previous period (pre-privatization).

The survey was distributed by hand and collected during the period of July-September 2010. A total of 186 questionnaires were returned, making a response rate of 83.7%. Of these 186 respondents, eight were excluded, because incomplete from respondents. This leaves the study with 178 useable respondents for data analysis and a final response rate of 80.1%.

**Variables Measurement:** Section (E) in questionnaire was designed to collect data about national culture, to measure four dimensions of national culture, Power distance (P.D), Individualism and collectivism (I.C), Uncertainty avoidance (U.A) and Masculinity and Femininity (M.F). This section contains on 16 questions adopted from [16,17,25].

Question (5) in questionnaire was concerned with participative budgeting, it is contents on four questions, these question were adopted from Harrison [20] and used

by Chow, Shields, and Wu [4]. We used binary variables of 1-3 for low-budget participation and 4-5 for high-budget participation respectively.

Section (G) in questionnaire was designed and aimed at collecting data about firm performance, its contain on five questions which were adopted from Libby and Waterhouse [31] and used by Cragg *et al* [32], the respondents were asked, on a scale from 1 (very weak) to 5 (very strong).

**RESULTS AND DISCUSSION**

**Reliability Test:** The reliability of scale indicates the stability and consistency with which the instrument is measuring the concepts and helps to assess the goodness of measure [33]. According to Hair, C.Black., Babin., and Anderson [34], reliability estimate of .7 or higher suggests a good reliability, but reliability between .6 and .7 may be acceptable. The result that the Cronbach’s alpha values indicate a good reliability for all variables; all variables have value higher than .70. Consequently, the questionnaires were distributed to the remaining 178 managers working in privatized firms in Libya.

**Correlation Matrix:** A correlation matrix for culture dimensions, budgetary participation and performance is given in Table 2. As expected, the correlation matrix shows that power distance is negatively correlated to budgetary participation while Masculinity is positively correlated to budgetary participation and no correlated between individualism, uncertainty avoidance and performance to budgetary participation.

**Measurement Models:** Structural equation modeling (SEM) was used to analyze the data using a two-stage process recommended by Schumaker and Lomax [35]. In the first stage, each latent variable was modelled as a

separate measurement model. A measurement model relates observed variables to their associated latent variable. In this case, the latent variables were culture dimensions (power distance, individualism, masculinity, uncertainty avoidance), participation in budgeting and firm performance. The second stage involved constructing the structural model by specifying the relationships between the latent variables. In this section, the first stage will be described. Formulating measurement models for each variable involved using (AMOS 18) to conduct confirmatory factor analysis for each set of items. Covariances were included between error terms in each measurement model where suggested by AMOS, but only where such covariances were justified theoretically.

Model fit is defined by [34], as the “degree to which the actual/observed input matrix is predicted by the estimated model”. There is no single measure of fit for structural equation models, so it is good practice to include a range of fit indices. Chi-square and the Goodness-of-Fit (GFI) index measures overall model fit. A non-significant chi-square indicates that the data fit the model, while the GFI index ranges from 0 (poor fit) to 1 (perfect fit) with an acceptable minimum of 0.90 [36]. The GFI is considered analogous to the R2 value reported in multiple regression models.

Details of the fit indices for each measurement model are shown in Table 3.

**Final Model:** In this study, structural equation modeling was used to analyze relationships between the variables of interest. This provided several advantages compared to the more commonly used techniques in management accounting, such as regression analysis. First, it allowed many relationships to be considered within a single analysis. This exposed insignificant relationships that would not have been revealed by a more selective correlation or regression analysis. Second, it allowed for error variances associated with multi-item constructs to be

Table 2: Correlations matrix

	P.B	PER	P.D	I.C	M.F	U.A
P.B	1					
PER	-.024	1				
P.D	-.232**	-.067	1			
I.C	.127	.054	.090	1		
M.F	.152*	.105	.201**	.015	1	
U.A	-.050	.174*	.327**	.178*	.061	1

\*\* Correlation is significant at the 0.01 level (2-tailed).

\* Correlation is significant at the 0.05 level (2-tailed).

Power Distance = P.D, Individualism / Collectivism = I.C, Masculinity / Femininity = M.F, Uncertainty Avoidance = U.A, Participation Budgeting = P.B, performance=PER.

Table 3: Goodness fit model

	df	Cmin/df	GFI	CFI	NFI	Rmsea	AIC
P.D	2	3.380	.982	.986	.980	.116	22.761
C.I	1	4.230	.988	.970	.963	.135	22.230
M.F	2	8.675	.956	.956	.951	.208	33.349
U.A	2	2.036	.989	.984	.971	.077	20.072
P.B	1	4.384	.988	.982	.977	.138	22.384
PER	1	13.232	.965	.950	.947	.263	31.232

Power distance = P.D, Individualism / Collectivism = I.C, Masculinity / Femininity = M.F, uncertainty avoidance = U.A  
 Participation Budgeting = P.B, performance=PER

Table 4: Hofstede's Study, Twati's Study and current study<sup>1</sup>: A comparison

Study\country	Small\large Power Distance		High\low Uncertainty avoidance		Masculinity\ femininity		Individualism\collectivism	
	Index	Rank	Index	Rank	Index	Rank	Index	Rank
Hofstede's study 1984	80		68		53		38	
(Arab World's) IBM Company*	44	45	24	25	28	29	25	
Twati's study 2008 (Libya)								
Oil Companies**	72		71		45		18	
Current study 2010 (Libya)	82		72		59		22	

Source: \* Hofstede [16], \*\*Twati [37]

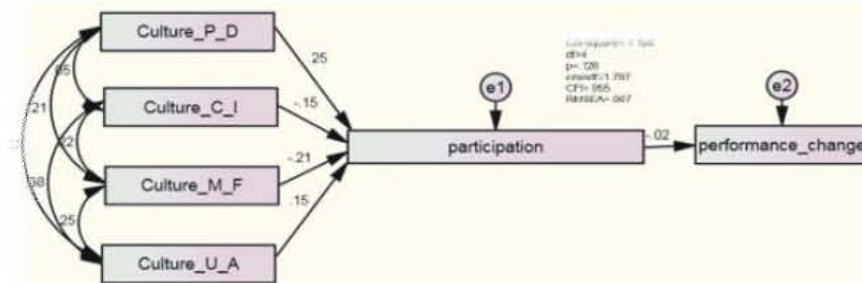


Fig. 2: Final model

incorporated into the model. This provides a means for the inaccuracies associated with the imprecise measurement of multi-item variables to be included specifically. Third, it allowed measures of fit to be determined.

The fit measures in the final model indicate a good model fit, Chi-square for the model of 7.88 (df=4, P=0.126) and the GFI (0.987) both indicate good overall fit. The comparative fit measures all indicate good model fit (IFI=0.961, CFI=0.955), as do the model parsimony measures (AGFI=0.931, AIC=41.188, saturated model=42.000). Each of these fit measures exceeds the accepted minimums.

**The Results:** The findings of the four cultural dimensions are presented in the following table (Table 4). In addition to the results reported by Hofstede [16], other results for Arab countries are also presented for comparison [37]. Surprisingly, the results of this study similar to Twati's study in Libya [38] in an era of

technology, globalization, and the Internet, produced results and Hofstede's [16] index. While many countries' indexes worldwide have changed since Hofstede's predictions of the 1970s, Libyan results remain similar to Hofstede's results of the 1970s. Twati [37], found that Libyan culture displays a high power distance, high uncertainty avoidance, collectivist and masculinity index.

The results also indicates that the level of participation in budgeting in Libya is low (the mean= 2.17), our finding thus corroborate Hofstede's [16] thesis and direct claim that there is likely to be greater concentration of authority at higher levels within firms in high power distance nations and the power and authority for decision making at higher levels in the organization, also find negative relationship between collectivism culture and level of participation in budgeting. This results is consistent with the finding of Chow *et al.*, [4], O'Connor [26] and Ueno and Sekaran [28].

<sup>1</sup> Hofstede (2008) study was based on regional estimated values conducted in 1984 (27 years) and within none industrial companies. Twati (2008b) study was based on data conducted in 2004 ( five years) and within Oil & Gas companies and Banks, current study was based on data conducted in 2010 and within small & medium size industrial firms.

Table 5: Regression Weights: (Group number 1-Default model)

			Estimate	S.E.	C.R.	P	
participative_budget	<---	Culture_P_D	.116	.045	2.605	.009*	sig
participative_budget	<---	Culture_U_A	.055	.039	1.419	.156	Not sig
participative_budget	<---	Culture_C_I	-.081	.039	-2.063	.039*	sig
participative_budget	<---	Culture_M_F	-.086	.046	-1.849	.065	Not sig
performance_change	<---	participative_budget	.005	.036	.129	.898	Not sig

Table 6: Summary of hypothesis testing

Hypotheses	Support/reject
H1a. There is negative relationship between high power distance culture and the level of participation in budgeting.	Support
H1b. There is negative relationship between high individualism culture and the level of participation in budgeting.	Rejected
H1c. There is negative relationship between high masculinity culture and the level of participation in budgeting.	Support
H1d. There is negative relationship between high uncertainty avoidance culture and the level of participation in budgeting.	Rejected
H2. There is no relationship between the level of participation in budgeting and firm performance.	Rejected

Our finding did not find any relationship between level of participation in budgeting and firm performance, Tsui [9] suggested that the interaction effects of MAS and budgetary participation on managerial performance were different, depending on the cultural background of the managers.

**Hypothesis Test:** Hypotheses H1 a-H1 d examined the relationship between national culture dimensions and the level of participation budgeting, while hypotheses 1a and 1c is supported, no significant relationship was found between uncertainty avoidance and Masculinity and participation budgeting, Therefore, hypotheses H1b and H1d are rejected.

The second hypotheses was H2 examined the relationship between level of participation budgeting and firm performance, no significant relationships were found between the variables, therefore the hypotheses H2 is rejected. This is consistent with prior empirical findings [4, 24, 26]. The table no (6) provides further insights into the relationships between the variables that have been examined and hypotheses test.

### CONCLUSION

Having examined the outcomes of the testing of the data and the hypotheses in the previous section, this section provides a more detailed examination of the findings of this study. National culture elements within Libyan manufacturing companies found to be high power distance, high masculinity, slightly high in uncertainty avoidance and collectivism element. The level of participation in budgeting is low. That is meaning there is an influence of culture on the level of participation in budgeting and the use of MCS within Libyan firms.

This study is the most recent to investigate the national culture profile within Libya, it makes contribution by providing an insight into which cultural values are operating within the society and findings will be add to our understanding about use of MCS within Libyan manufacturing companies.

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