Too much of a good thing?
Examining the interactive effects of financial and relational slack

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DRAFT
Abstract

This paper examines the interactive effects between financial slack and relational slack on exploitative activities among a representative sample of German nonprofit organizations. Exploitative activities are defined as expansion of existing or proven programs and services. This is in contrast to explorative activities, which are defined as innovative and new programs and services with unknown rates of success or effectiveness. Financial slack is defined as the difference between revenue and expenses divided by total revenue. Relational slack is measured three ways: collaboration with nonprofits; collaboration with for-profits; and collaboration with government. Financial slack is hypothesized to have a negative relationship with exploitative activities. However, relational slack is hypothesized to positively attenuate this relationship. Results find partial support for hypothesis 1 and 2, in particular with collaboration with governments. Implications of findings for research and practice is discussed.
Introduction

In organizations, excess resources are often an indication of inefficiency. However, excess resources may also allow managers to be innovative, expand current services, or respond to unforeseen environmental shocks (Voss et al., 2008; Christensen & Frankforter, 1995). For nonprofits in particular, excess organizational resources imply less services for vulnerable clients and thus many donors and funders expect nonprofits to operate at a “break-even” level (Lohman, 1980). Excess organizational resources, or “slack,” come in many forms and arise for a number of reasons. Organizational slack is defined by Cyert and March (1992) as the, “...disparity between the resources available to the organization and the payments required to the coalition.” The “coalition” refers to the various stakeholders impacted by the firm's activities (i.e., owners, customers, and shareholders in the for-profit case and clients, donors, regulators in the nonprofit case). In line with common perceptions, Cyert and March's (1963) definition implies that organizational slack may be financial in nature, in the form of cash reserves, lines of credit, or profits. However, researchers also identify three other forms of slack: relational slack, operational slack, and human resource slack (Voss et al., 2008; Wiersma, 2017).

Each form of slack, depending on how difficult it is to obtain (rarity) and the ease by which it can be deployed (absorption), allows organizations to either innovate and develop new products and services or to expand on well-known and proven products and services (Voss et al., 2008). How organizational slack is used, innovation or expansion, may also depend on the environment in which the organization operates (Voss et al., 2008; Kistruck et al. 2013; Christensen & Frankforter, 1995).

In this paper, we apply and test the slack concept to a cross-sectional and representative sample of about 6,000 nonprofit organizations in Germany. Specially, we will examine two forms of slack, financial and relational, and its interaction, on measures of organizational performance. This paper will proceed as follows: the next section will review the literature on organizational slack and its application on nonprofit organizations followed by a statement of our hypotheses; then we will discuss our methods and measures; the results will then be presented; and this paper will conclude with a discussion of the implications of our findings for research and practice.
Organizational slack is a well researched topic in the management literature. The development of this concept is grounded in the development within different theoretical traditions. But it has been mainly credited to Cyert and March (1992) who proposed a behavioral theory of the firm that allowed for reflexive firm behavior rather than a one dimensional profit maximizing behavior. Thus, behavioral theories posit that the goal of firms is not merely profit-maximization but survival (Christensen & Frankforter, 1995). Under the assumption of profit-maximization, firms are expected to have no organizational slack as all excess resources are expended on products and services. However, under the assumption of firm survival, managers have discretion as to how resources are used to ensure survival (Christensen & Frankforter, 1995). Thus, organizational slack is defined by Christensen & Frankforter (1995), “…as resources available to an organization to facilitate its goal of survival by funding discretionary decision making that allows the organization to maintain internal task effectiveness and adaptation to forces in its external environment." (p339).

As such, much of the research on organizational slack focuses on the reasons for the creation of slack (Busch & Gustafsson, 2002; Duizendstraal and Nentjes, 1994); what drives managerial discretion to deploy specific forms of slack (citation) and how slack resources are used (Wiersma, 2017; Voss et al, 2008).

Voss et al’s (2008) study of nonprofit theatres offers a framework that conceptualizes four types of slack: financial, customer relational, operational, and human resources. Further, each type of slack has varying degrees of rarity and absorption. Depending on the combination of these two characteristics and the type of slack, organizations may either pursue “exploratory” activities to innovate and discover new, but unproven programs and services; or they may pursue “exploitative” activities that expand on existing and proven programs and services.

First, financial slack refers to the level of cash or liquid assets on hand. Customer relational slack refers to, “…the slack attributable to relational, or committed, customers, who are valued resources providing tangible benefits to an organization.” (p150) Voss et al (2008) distinguishes between a relational or repeating customer or stake-holder versus one that engages in an only one-time transaction. Thus,
relational slack is social capital that can be translated into increased revenue or other tangible resources. Operational slack refers to “…unused or underutilized operational resources, such as excess production capacity.” (p150). Finally, human resources slack refers to the specialized skills of organizational staff.

In addition to its distinguishing features, each type of slack also has varying degrees of rarity and absorption. Rarity refers to the difficulty or ease at which each slack can be procured, created, or developed; and absorption refers to the ease or difficulty at which each type of slack can be deployed. For example, financial slack is both a non-rare and un-absorbed resource. Voss et al (2008) argues that financial slack is un-rare or common because it can be relatively easily generated by simply cutting costs or increasing revenue, thereby building an organization’s cash reserves. Financial slack is also un-absorbed because it is unrestricted, in particular if created through profits, and liquid and thus can be deployed to whatever uses the organization deems fit. Customer relational slack is rare and un-absorbed. Relational slack is rare because it takes time and commitment to develop trusting and long term relationships that can be translated to tangible resources. Once developed, however, relationship slack is relatively un-absorbed, that is, it can result in increased revenue and thus deployed to whatever uses the organization deems fit. Operational slack is fairly common (un-rare) but also not easily deployed (absorbed). While organizations have a lot of resources to produce its services and programs, once these resources are committed, it cannot be easily moved or re-deployed to other uses. Finally, human resources slack is both rare and absorbed. That is, highly skilled and specialized human labor is difficulty to find, and once an organization has it, given its specialized nature, it is difficulty to re-deploy this resource for other uses.

Given these characteristics, Voss et al (2008) examines each type of slack on two organizational activities: exploratory and exploitative. As Voss et al (2008) defines, “Product exploration as an organizational emphasis on introducing radical innovations that extend existing product competencies;” and “Product exploitation is defined as an organizational emphasis on marketing existing or incrementally modified products that capitalize on existing product competencies.” (p148). Voss et al (2008) tests the main effects of the four types of slack on their outcomes (exploitative and explorative activities) and finds no support for a positive relationship between financial slack and exploration or a negative relationship between financial slack and exploitative activities. They do find support for a negative main effect.
between relational slack and exploration but no support for a positive relationship between relational slack and exploitation. For operational slack, they find support for a negative main effect with exploration and a positive main effect with exploitation. For human resources slack, they find no support for a negative main effect with exploration and weak support for a positive main effect with exploitation. Further, Voss et al (2008) finds support for interactive effects between financial and relational slack environmental threat. Specifically, they find that under environmental threat, theaters are more likely to engage in exploration as financial slack increases (steeper positive slope) and less likely to engage in exploitation as financial slack increases (steeper negative slope). For the interaction with relational slack, they find that when the environment is perceived as threatening, organizations are more likely to engage in exploration with higher levels of relational slack (flatter negative slope); and organizations are less likely to engage in exploitative activities with increasing relational slack (flatter positive slope).

Drawing from Voss et al’s (2008) framework, this study will examine the relationship between financial and relational slack on exploitative activities, defined as expansion of existing products or services. First, following Voss et al (2008), we expect that increases in financial slack will allow organizations to be more innovative and invest in radical and new programs and services that may have uncertain returns, and that organizations will invest less in expansion of existing programs and services, all else equal. Given that we don’t have measures of explorative activities and only measures of exploitative activities, this leads us to the following hypothesis:

- (H1): Increases in financial slack will be related to lower exploitative activities; that is, we expect to see a negative relationship between financial slack and exploitative activities.

Given that relational slack is rare and unabsorbed, organizations may not want to endanger existing relationships by engaging in radical and unproved programs and services; rather, organizations may be more likely to expand on current services and competencies that have proven track record of success. This leads to the second hypothesis:
• (H2): Increases in relational slack will be related to higher exploitative activities; that is, we expect to see a negative relationship between relational slack and exploitative activities.

Finally, given that organizations will have more than one type of slack, there may be an interactive effect. Specifically, while we expect that as organizations have more financial slack, they may be less likely to engage in expansion of existing activities (exploitative), but that existing relationships with stakeholders may attenuate their negative tendency to exploitative activities. This leads us to our third hypothesis:

• (H3): Relational slack will moderate the relationship between financial slack and exploitative activities so that the slope between financial slack and performance is positive in the presence or relational slack.

Next we turn to a discussion of our data collection method and measures before presenting our results.

Methods

The sampling and data collection is based on the project ZiviZ-Survey, the only representative survey of nonprofit organizations in Germany. In Germany, there are four main types of NPOs when looking at all registered nonprofit associations. These are clubs, foundations, charitable GmbHs (so called “gGmbHs” and cooperatives. Together we count 633,922 organizations in the German nonprofit sector.

For our study 71,382 organizations were randomly selected and got the ZiviZ-Survey to participate. The survey takes about 20 to 30 minutes and can be filled out on paper as well as online. Most organizations fill out the paper form. Usually it is the head of the organizations that fills out the
survey but it can be any person that knows the own organization well. A total of 6,334 organizations took part in the survey.

The data was weighted according to legal forms. Clubs were also weighted by state. Due to the lower number of cases in the other legal forms in individual federal states such a weighting does not make sense for all legal forms, which is why foundations, charitable GmbHs and cooperatives were not weighted by federal state.

Measures

Outcomes. We examine two outcomes to measure exploitative activities, the first outcome is relevant for all organizations, and the second outcome only focuses on organizations in the education field. This allows us to have a special focus on the most important NPO fields in Germany, a field which is growing. Our first measure of exploitative activities is for all respondents with the question “How often does your organization offer the following activities and services?” (B3) Respondents were given the following six categories with three possible response choices, “often, sometimes, never:” (a) support with daily matters; (b) financial support; collecting and distributing donations in-kind; (c) on-site inter-cultural exchanges; (d) international exchanges and international cooperation; (e) maintaining religion and the practice of religion. A response of “often” was coded “3;” sometimes was coded 2; and never was coded 1. The final additive measure is a sum of all six categories with a range from 6-18 (see Table 1).

The second outcome focuses on organizations in the education field with the following question, “How often does your organization offer the following activities and services?” (F4) Respondents were given the following nine categories with three response choices, “often, sometimes, never:” (a) after-school activities; (b) language courses and language support; (c) educational tours; (d) museums and experience-based educational services; (e) cultural educational services; (f) sports and movement services; (g) help in integrating into the job market; (h) professional development and further qualification services; (i) general further training and qualification services. A response of “often” was coded “3;” sometimes was coded 2; and never was coded 1. The final additive measure is a sum of all nine categories with a range from 9-27 (see Table 1).
Predictors. Financial slack was created by taking the difference between revenue ("How high was the total revenue of your organization in the budget year 2015?" H3) and expenditure ("How high was your organization's total expenditure in the budget year 2015? (H1), and dividing the difference by total revenue. Thus, positive values indicate that the organization earned a profit and negative values indicate a deficit. The self-reported nature of this question resulted in high variation in values. For example, the lowest value was -1,117,646%, reported by an organization with reported expenditures of 19,000,000 Euros and revenue of 17 Euros. The highest value was 99.99% by an organization with reported revenue of 2,571,000 Euros but only reported expenditure of 1 Euro. These extreme values may not indicate actual values and appear to be highly unlikely. Thus, we exclude margin values that are less than 0 (i.e., where expenditure is greater than revenue) and margin values greater than 50% (i.e., where revenue was more than twice as much as expenditure). These exclusions resulted in a final sample of 3,361 observations (see Table 1).

Relational slack was measured by the following three questions: "How often is your organization in contact with other charitable organizations (E1);" How often is your organization in contact with politicians or administrations (E3);" and "How often is your organization in contact with companies and workplaces (E5)." For each question, respondents were given the following four categories with three possible response choices, "often, sometimes, never:" (a) contractual basis; (b) sponsor relationship; (c) partner relationship; (d) network. A response of "often" was coded "3;" sometimes was coded 2; and never was coded 1. The final additive measure is a sum of all four categories with a range from 4-12 (see Table 1).

Controls. Two control variables were considered in the model. The first was age, measure as the difference between the year the survey was conducted (2017) and the response to "When was your organization founded?" (A1). (See Table 1 for summary statistics) The second control variable used the following question, "How has revenue developed since 2012?" (H4) with three response categories: "risen; sank; unchanged." This variable was treated as a categorical variable and converted into three dichotomous variables in the model.

Analysis. In addition to the excludes based on outlying margin values, we also excluded organizations with the following legal structures: "incorporated foundation in law" and "incorporated
foundation without legal capacity." (A3) Models were estimated with OLS regression models and probability survey weights in Stata 15.

Results

Summary statistics

Table 1 presents a correlation matrix and summary statistics for all variables in the model. Pearson’s correlation values suggest that multi-collinearity is not an issue. The mean values for the outcome variables are 7.27 (with range from 1-17) and 12.20 (with a range from 2-27). The mean margin value is 10% indicating that organizations in our sample earn, on average, a profit of 10% total revenue. The mean values for relational slack, measured as collaboration, are 6.69, 6.40, and 6.09 for collaboration with nonprofits, government, and for-profits respectively. The average age of organizations in our sample is 38.23 years (with a range from 0, founded in 2017, to 557 years). Finally, 45.54% of the sample indicated that revenue has gone up; 16.93% indicated that revenue has declined; and 37.53% indicated that revenue has remained unchanged.

Regression results

Table 2 presents the regression results for the first outcome variable, exploitative activities for all organizations. Model 1 presents estimates with no interaction terms and Model 2 presents the results with interaction terms. For model 1, the margin coefficient, while negative, is not statistically significant. The coefficient values for collaboration with nonprofits and government is positive and statistically significant at p<.05 and collaboration with for-profit is positive and marginally significant at p<.10. Organizations that experienced a revenue increase engaged in (0.24) more exploitative activities compared to organizations with revenue that were unchanged.

For model 2, the margin coefficient is negative and marginally significant (p<.10). The interaction term between margin and collaboration with other nonprofits is negative and marginally significant and the
interaction term between margin and collaboration with for-profits is positive and marginally significant. The interaction term between margin and collaboration with government is statistically significant (p<.05) and positive. Similar to Model 1, organizations that experienced a revenue increase engaged in more exploitative activities compared to organizations with revenue that were unchanged.

Figure 1 is a graphical representation of the estimates of Model 2 (Table 2) and plots the relationship between margin and the outcome (exploitative activities) at four collaboration types: no collaboration (or when values for collaboration are held at zero); at the average level of collaboration with nonprofits; at the average level of collaboration with for-profits; and at the average level of collaboration with government. The no collaboration slope (solid black line) is negative but only marginally significant. At average levels of collaboration with nonprofits only (dotted line), the slope is also negative and steeper than the no collaboration slope but also only marginally significant. When nonprofits collaboration with either for-profits or governments, the relationship between margin and the outcome is attenuated and becomes positive. The slope for the for-profit collaboration (dashed and dotted line) is only marginally significant, but the slope for government collaboration (dashed line) is statistically significant.

Table 3 presents the regression results for the second outcome variable, exploitative activities for organizations engaged in educational activities. Model 1 presents estimates with no interaction terms and Model 2 presents the results with interaction terms. For model 1, the margin coefficient is negative and statistically significant. The coefficients for collaboration with nonprofits and government are positive and also statistically significant. For model 2, the main effect nonprofit and government collaboration terms are positive and statistically significant. For the interaction terms, only the margin and collaboration with nonprofits term is marginally significant (p<.10) and negative.

Figure 2 is a graphical representation of the estimates of Model 2 (Table 3) and, similar to Figure 1, plots the relationship between margin and the outcome (exploitative activities) at four collaboration types: no collaboration (or when values for collaboration are held at zero); at the average level of collaboration with nonprofits; at the average level of collaboration with for-profits; and at the average level of collaboration with government. The no collaboration slope (solid black line) is positive but not significant. At average levels of collaboration with nonprofits only (dotted line), the slope is negative but
only marginally significant. When nonprofits collaboration with either for-profits or governments, the relationship between margin and the outcome is positive but not significant.
Table 1. Summary statistics and correlation matrix (all variables)

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<th>4</th>
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<tr>
<td>(1) Outcome #1 (six items)</td>
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<td>(2) Outcome #2 (nine items)</td>
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<td>(3) margin(a)</td>
<td>-0.07</td>
<td>-0.12</td>
<td>-</td>
<td></td>
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<tr>
<td>(4) nonprofit collaboration (four items)</td>
<td>0.30</td>
<td>0.27</td>
<td>-0.15</td>
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<tr>
<td>(5) government collaboration (four items)</td>
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<td>0.31</td>
<td>-0.15</td>
<td>0.49</td>
<td>-</td>
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<td>(6) for-profit collaboration (four items)</td>
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<td>(8) revenue gone up (1=yes 0=no)</td>
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<td>0.13</td>
<td>0.03</td>
<td>0.19</td>
<td>0.16</td>
<td>0.16</td>
<td>-0.11</td>
<td>-</td>
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<td>(9) revenue decline up (1=yes 0=no)</td>
<td>-0.05</td>
<td>-0.05</td>
<td>0.02</td>
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<td>(10) revenue unchanged (1=yes 0=no)</td>
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<td>0.08</td>
<td>-0.71</td>
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Observations: 3,151 1,356 3,361 3,261 3,284 3,254 3,290 1,517 564 1,250
Mean: 7.27 12.20 0.10 6.69 6.40 6.09 38.23 45.54 16.93 37.53
Median: 7 12 0.048 7 6 6 25 - - -
Stand Dev: 2.40 4.79 0.13 2.27 2.30 2.10 40.97 - - -
Min: 1 2 0 1 1 1 0 0 0 0
Max: 17 27 0.5 12 12 12 557 1 1 1

(a) margin=(revenue-expenditure)/revenue
(b) age = 2017 - (year found)
Table 2. Multiple regression results (outcome #1 all organizations)

<table>
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<tr>
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<th>Model 1</th>
<th>Model 2</th>
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<td>0.25**</td>
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<tr>
<td>for-profit collaboration</td>
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<td>0.03</td>
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<tr>
<td>government collaboration</td>
<td>0.06**</td>
<td>0.03</td>
</tr>
<tr>
<td>margin X nonprofit collaboration</td>
<td>-0.42*</td>
<td>0.24</td>
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<td>0.00</td>
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<tr>
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<tr>
<td>gone up</td>
<td>0.24**</td>
<td>0.11</td>
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<tr>
<td>declined</td>
<td>0.11</td>
<td>0.15</td>
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<tr>
<td>constant</td>
<td>4.89**</td>
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R(sq) 0.09  0.10
N 2,921  2,921

*p<.10
**p<.05

Table 3. Multiple regression results (outcome #2 education organizations)

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<td>constant</td>
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R(sq) 0.10  0.11
N 1,288  1,288

*p<.10
**p<.05
Figure 1. Outcome #1 - all organizations

Margin

- no collab
- np collab
- fp collab
- gov collab
Figure 2. Outcome #2 - Education organizations only

- **no collab**
- **np collab**
- **fp collab**
- **gov collab**
Discussion

This analysis tested three hypotheses: (H1) negative relationship between financial slack and exploitative activities under no relational slack; (H2) positive relationship between relational slack and exploitative activities; (H3) interactive effect between financial and relational slack where financial slack and exploitative activities is positive in the presence of relational slack. The three hypotheses were tested for all organizations and sub-sample of organizations engaged in educational activities. Partial support was found for hypotheses 1 for when tested on all organizations but no support for organizations engaged in educational activities. For all organizations (outcome #1), support was found for hypotheses 2 and 3 when collaborating with government; partial support for hypotheses 2 and 3 was found for collaboration with for-profit; no support was found for collaboration with nonprofits. For organizations engaged in educational activities (outcome #2), support was found for hypotheses 2 only for collaboration with government and partial support was found for hypothesis 3 in the opposite direction for collaboration with nonprofits.

Under no collaboration, greater financial slack (i.e. higher profits) is predicted to be related to lower exploitative activities. One explanation for this maybe drawn from Voss et al (2008) who hypothesized that as organizations gain more financial slack they are more likely to engage in innovative, exploratory activities rather than on expansion of existing activities. While we do not have specific measures of innovative exploratory activities in this study, a negative relationship between financial slack and our first outcome measure implies that nonprofits may be engaging in other types of activities as financial slack increases. A second explanation is that nonprofits are risk averse and rather than engaging in exploratory activities, they are simply building reserves for future contingencies. It also appears that when respondents build relational slack with other nonprofits, they are even less likely to expand on current activities. That is, if the second explanation is true, then nonprofits appear to be reinforcing each other’s risk aversion.

Building relational slack with government collaborators appear to be the most consistent and significant finding. Relational slack with government attenuates the negative relationship between financial slack and exploitative activities. This is in contrast to Voss et al (2008) findings but is consistent
with their hypothesis of a positive relationship between relational slack and exploitative activities. Voss et al. (2008), however, did not examine an interaction effect between financial slack and relational slack as we did here. Thus, following Voss et al.’s (2008) argument, nonprofits appear to value its partnership with government (relational slack) and thus more willing to expand on existing services.

Limitations and future steps

Imprecise measures of exploitative activities, relational slack and financial slack; self-reported nature of financial variables; also assumes that all margin is unrestricted and liquid which may or may not be the case. The coefficients were also rather small, increases in the covariates predicts less than a one point change in the outcome. No measure of environmental conditions. No exact measures of absorption or rarity.

Future analysis may disaggregate the collaboration between “formal” collaboration and “informal” collaboration. Examining “formal” collaboration may be a more accurate measure of what Voss et al. (2008) would consider long-term “relational slack.”

Conclusion

This paper demonstrates the impact of financial and relational slack on exploitative activities among a representative sample of German nonprofits. Findings indicate the presence of an interactive effect between financial and relational slack. That is, the impact of financial slack on exploitative activities is moderated by relational slack, in particular relational slack created by collaboration with government partners. Findings support prior literature on the impact of slack on exploitative activities among nonprofits. This initial study is the first to examine slack in a sample of German nonprofits. Future studies will examine explorative in addition to exploitative activities.
References


