

SECTION - I I

A THEORETICAL ANALYSIS

C H A P T E R - 3

ORGANISATIONAL SLACK : A CRITICAL ANALYSIS

As pointed out earlier, Cyert and March introduced the concept of organisational slack in their Behavioural Theory of the Firm as a hypothetical construct to indicate slack variables which lead to stability of the firm as an organisation or coalition of members by protecting it from external environmental changes. The salient features of the Behavioural theory are (i) information is not cost-free, (ii) search for alternatives are initiated only when a problem is encountered, (iii) problems are attended sequentially, (iv) solutions successful in the past will be taken up at once the problem is faced. If the solution fails, then only search for alternatives will be triggered off, and (v) adoption of aspiration adjustment mechanism, (vi) the firm has five goals. The following three figures explain effectively the decision making process and the importance and role of organisational slack in the theory.¹

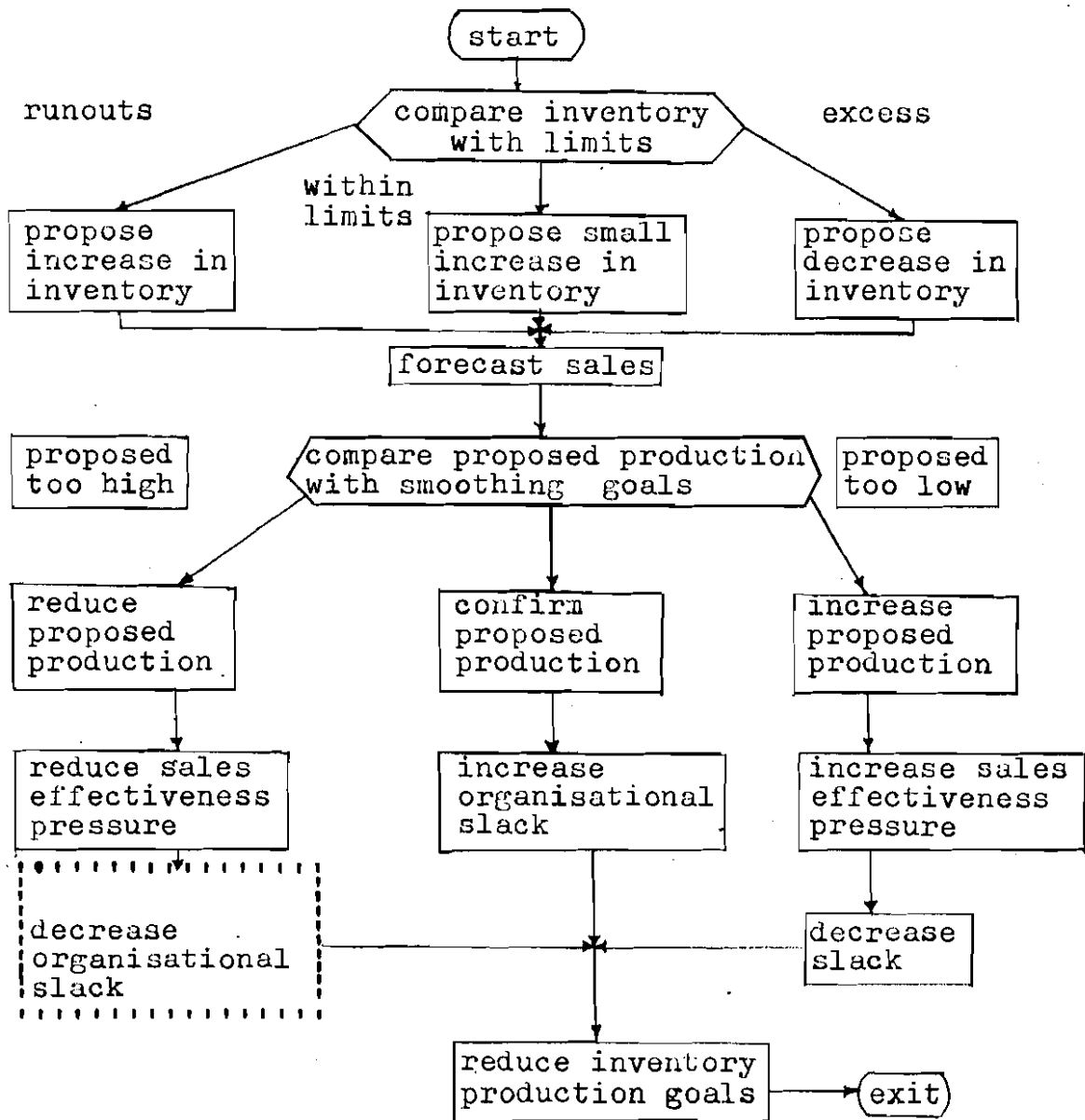


Fig-3.1 : Output decision process.

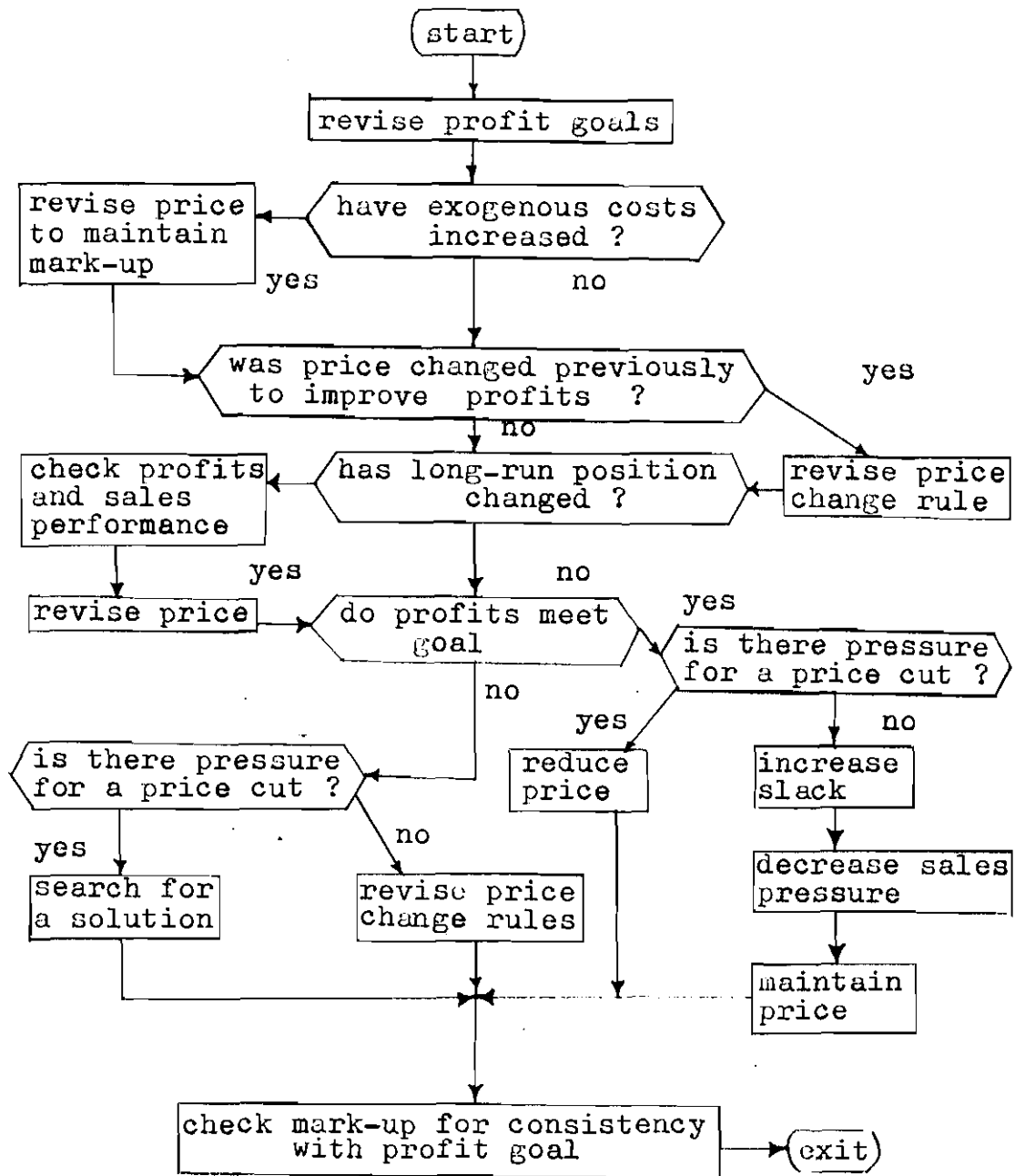


Fig -3.2 : Price Decision process.

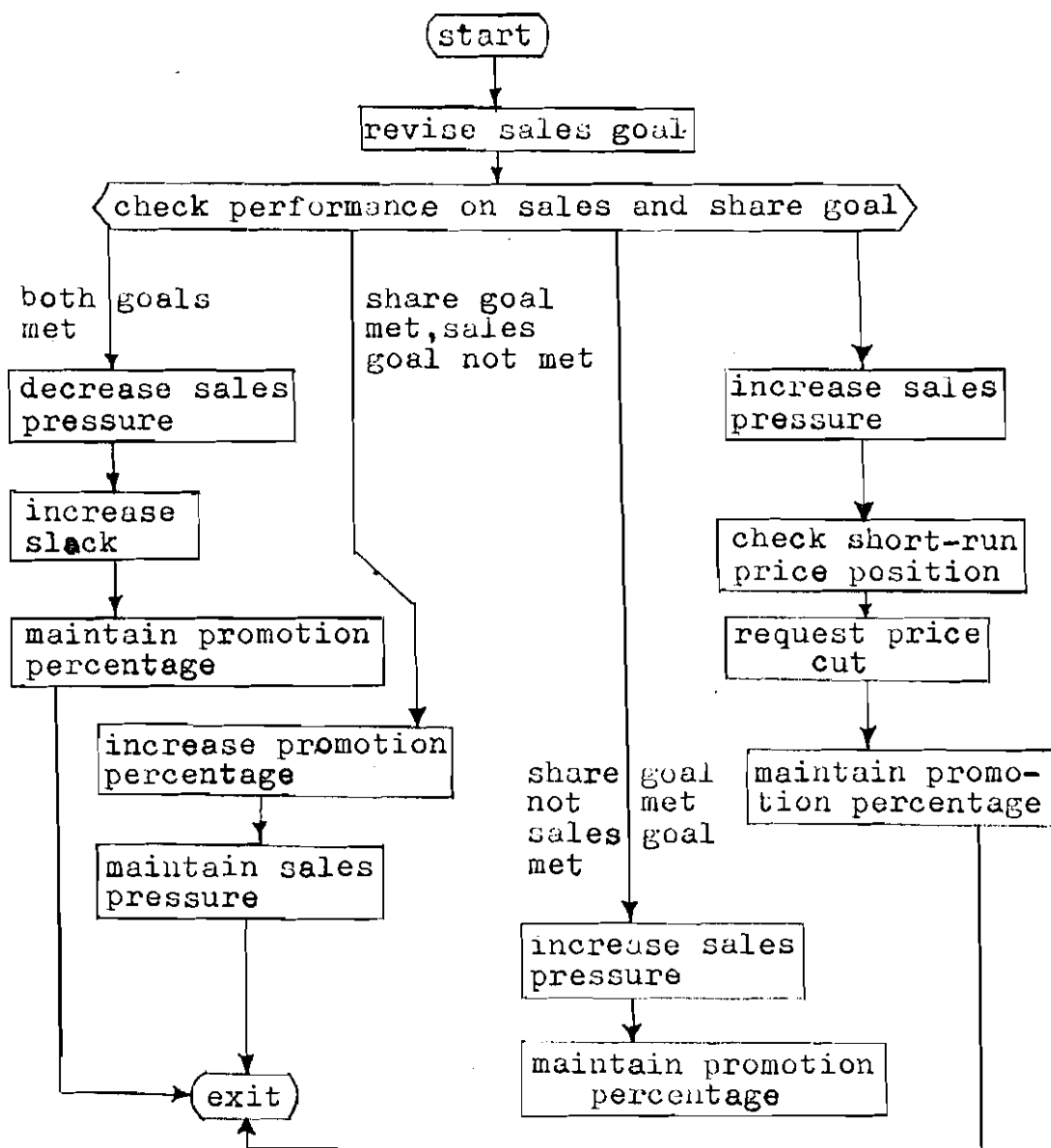


Fig - 3.3 : Sales strategy decision process.

They distinguished between two kinds of organisational slacks : (i) slack in the marketing - sales function on the one hand and (ii) slack in the production function on the other. They are related by their mutual dependence on external conditions but are partially independent.²

Cyert and March stated that virtually every participant in the organisation obtains slack payments. However some participants ordinarily obtain a greater share of the slack than others. "In generalmembers of the coalition who are full time, in a position to perceive potential slack early, or have some flexibility in unilateral allocation of resources will tend to accumulate more slack than will other members."³ However they have not attempted to analyse, in detail, the implication of such differential distribution of slack within the organisation.

Organisational slacks absorb a significant portion of the potential fluctuation in the firm's environment. As a result, it plays both to stabilise the firms and thus to adopt the firm to environmental fluctuations.

In particular, organisational slacks seem to be useful in dealing with the adjustment of firms to variations in the external environment. For example, when the rate of improvement in the environment is high enough it outruns the upward adjustment of aspirations. In a general way this seems to be the situation that firms face during strong boom periods. When the environment outruns aspirational level adjustment, the firm secures resources in excess of its demands. Some of these resources are not obtained, although they are available. Others are utilised to meet the revised demands of those coalition members whose demands adjust more rapidly. That is those most deeply involved in the organisation. When the environment becomes less favourable, organisational slack functions like a cushion. Resource scarcity brings on renewed bargaining and tends to reduce the excess payments introduced during good times. It does not mean that those demands that were increased during good days are pruned abnormally during bad ones. But in general we would expect this to be approximately the case. "More important the cushion provided by the organisational slack permits firms to survive in the face of adversity. Under the pressure of a failure (or impending failure) to meet some set of demands of the

coalition, the organisation discovers some previously unrecognised opportunities for increasing the total resources available. For example, M.W. Reder reports that after losses of about fifty million dollars for the first three quarters of 1946, the Ford Motor Company announced that it had found methods of reducing operating costs (on a given volume of output) by about twenty million dollars per year."⁴

If the only adaptive mechanism, available to the firm, were adjustment in the aspirational level, the system would be quite unstable in the face of an environment of even moderate fluctuations. Organisational slacks stabilise the firm in two ways : (i) by absorbing the excess resources, it dampens the upward adjustment of aspiration during good times ; (ii) by releasing a pool of emergency resources it permits aspirations to be achieved and maintained during bad times.

3.1.1 WHO MANIPULATES ORGANISATIONAL SLACKS ?

Cyert and March seem to suggest that nobody is solely responsible for the creation of organisational slacks. They maintained that

organisational slack is created automatically without any conscious intent on the part of the coalition members. Also they seem to suggest that the oligopolistic nature of the firm is the determinant of organisational slack.

3.1.2 WHAT IS STABILISED ?

From the decision processes, as shown in the flow charts by Cyert and March, it can logically be derived that the stability of the organisation is parametered by (i) total revenue or (ii) profits before tax or (iii) profits after tax i.e., reported profits. The reported profits seem to be the main parameter as is suggested in a number of studies. Figure-3.4 explains this.

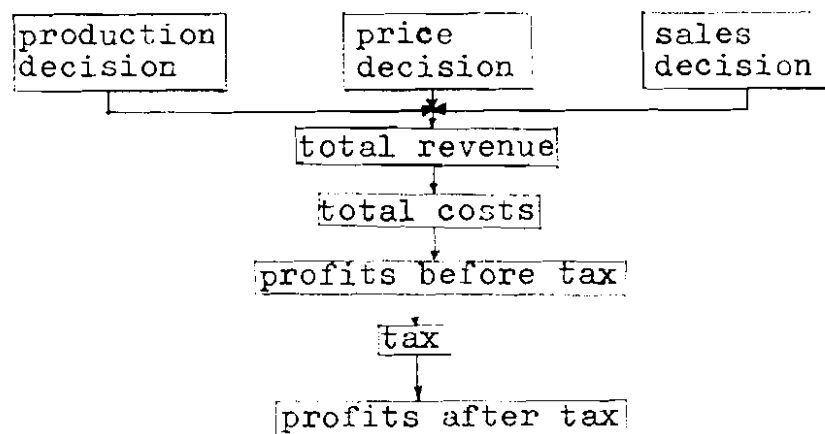


Fig-3.4 : Smoothing of reported profits.

3.2.0 INCONSISTENCIES IN THE DEFINITION OF
ORGANISATIONAL SLACK AND THE VARIABLES :

3.2.1 Dividends :- It is the profits after tax or the reported profits that is stabilised / smoothed as also suggested by a number of studies.⁵ According to Cyert and March reported profits is stabilised by appropriately manipulating organisational slacks which includes dividends paid to the owners of the organisation. To quote them : " Many forms of slacks typically exist : shareholders are paid dividends in excess of those required to keep shareholders (or banks) within the organisation."⁶ This means during good times organisational slacks are increased to absorb the shock to provide stability to the organisation. Thus dividend, as one of the organisational slacks, is also manipulated (in this case excess dividends are paid) to provide stability to the organisation. That is dividend is considered as a pre-reported-profits phenomenon. Figure-3.5 illustrate this point.

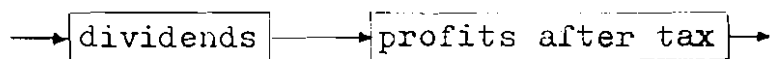


Fig-3.5 : Dividend as pre-reported profits phenomenon.

In practice dividends are declared only after arriving at the reported profits. If dividends are manipulated it can only be after profits-after-tax are calculated. That is dividend is a post-profits-after-tax phenomenon as illustrated in Figure-3.6.

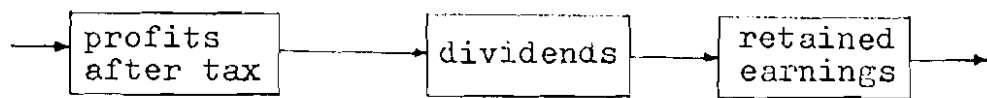


Fig-3.6 : Dividends as post-profits-after-tax phenomenon.

The inconsistency is that Cyert and March have treated the post-profits-after-tax dividends as a pre-profits-after-tax phenomenon. Dividend can not be an organisational slack since it can not be manipulated to yield the desired reported profits. That is the manipulation of dividends does not affect the reported profits. But the manipulation of reported profits does affect the dividends. (i) Since they included dividends also as organisational slack, the definition of organisational slack itself breaks down (from the point of view of the function organisational slacks are supposed to do i.e., to affect reported profits) to inconsistency

and invalidity. (ii) Since dividend is not an organisational slack the dividends receivers-shareholder, owners of the firm-do not become the members of the coalition as Cyert and March stated, " slack consists in payments to the members of the coalition in excess of what is required to maintain the organisation."⁷ Thus the criterion by which one becomes the coalition member becomes unclear.

At this point a natural question may arise. Supposing that the profits-after-tax are calculated at the end of the accounting year and dividends are declared, what if the firm declares interim dividend i.e., quarterly or half yearly dividends ? That is profits after tax being calculated after the completion of the accounting year, dividends are paid before the completion of the accounting year. Though this point may look inconsistent at first, it is not. To explain this point it is assumed that the firm declares half-yearly interim dividend. If after the completion of six months, the resultant total income, ceteris paribus, equals or exceeds half the forecasted or smoothed total income, an interim dividend less than or equal to the

forecasted dividend may be paid. After the completion of the accounting year a dividend equal to smoothed dividend minus interim dividend may be paid. Thus it may now be clear that the manipulation of dividends does not affect the reported income (a parameter of the performance of the firm). In fact, it is the reported income which affects dividends and not vice versa. This idea is reflected in the following figure-3.7.

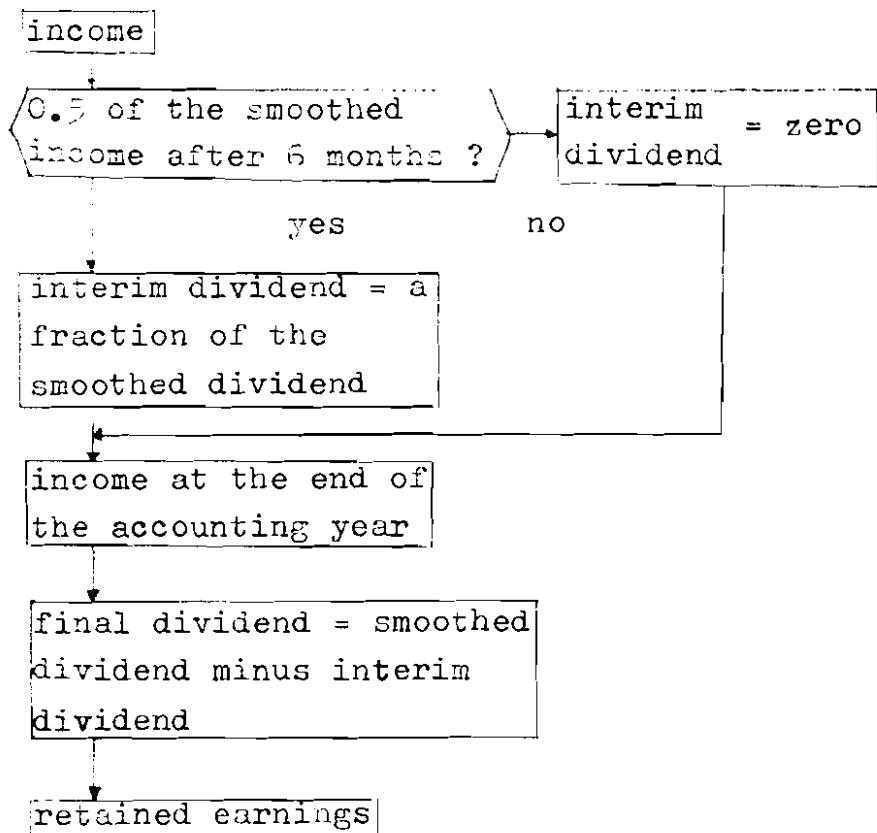


Fig-3.7 : Half-yearly interim dividends.

Thus the treatment of dividend as an organisational slack is erroneous and the definition of organisational slack and coalition member inconsistent and invalid.

3.2.2 Sub-optimal pricing :- Another inconsistency is the treatment of sub-optimal pricing as an organisational slack. Cyert and March stated that "many forms of slack typically exist :....prices are set lower than necessary to maintain adequate income from buyers."⁸ It is important to note that while giving the forms of slacks they have shown the picture that happens during 'good' times. That is during good times prices are lowered or set lower than necessary, as they call it sub-optimal pricing, to maintain adequate income from buyers.

Now the following questions arise :
 by setting sub-optimal prices, according to the function of the organisational slack, during good times it absorbs a substantial portion of the shock, what is absorbed ? During bad times, if bad times immediately follow a good time, what is released ? Will the prices set during good times be still lowered or increased ? More specifically let us assume that

period T1 is a good period. During this period, let us also assume a single product case for simplicity, the price set at P1, a sub-optimal level. Supposing T1 is followed by a bad period T2, will the P1 be increased or reduced further to set the new price P2 ?

In case, ceteris paribus, P2 is set higher than P1 (price increased), it is doubtful whether the new price will maintain the income stream. Because if a price P1 lower than P2 could not maintain the income stream, then it is doubtful that the higher price could maintain it. The impact of price increase may be neutralised by sales reduction. In fact, the income stream may decrease.

In case P2 is set lower than P1 (price is reduced) it is also doubtful whether **the** new price will maintain the income stream. Because the increased sales effect will be neutralised by the reduction in the price. Thus both the alternatives do not seem to sound well and hence the inconsistency.

However it seems logical and feasible that the firm, during good times instead of setting the price at sub-optimal level, can set at the optimal level. If the firm faces bad times, then it can gradually approach towards the sub-optimal price to maintain the profit stream.

Another point needs some consideration. Cyert and March's conclusions and their Behavioural Theory of the Firm are based on the case study of a departmental store, Irwin (1981) would call it a middleman firm that buys goods for resale. "However a subsequent investigation by Baumol and Stewart (1975) "confirmed that (the) results are very similar to those obtained in a behaviourist study of a departmental store in a different city."⁹ However it is our contention that these decision rules may apply to any departmental store at any time at any place but may not necessarily apply to any other firm particularly manufacturing ones. Because especially pricing decision process in manufacturing or any other firm will be much more complex than adding a percentage of mark-up to the purchase prices of 'already priced' goods for resale.

3.2.3 Inconsistency in the output decision process :- ¹⁰

The third inconsistency occurs while they give the output decision process (i.e., in the figure-3.1). If the proposed production is too high during good times, in comparison with the smoothing goals, proposed production is reduced, sales effectiveness pressure is reduced and organisational slack is also reduced. This act of reducing the organisational slack raises the inconsistency. They have stated that, "an increase in sales slack (i.e., a decrease in 'sales effectiveness pressure') ... (is) ... an increase in general organisational slack."¹¹ According to their logic when the sales effectiveness pressure is reduced, sales slack and organisational slack are increased. But in their decision process flow-chart they contradictorily 'decreased the slack.' This point is pointed out in the output decision process by illuminating the relevant portion in Figure-3.1.

NOTES

1. These diagrams have been reproduced for effective description and convenience from

- Cyert and March (1963), pp-152, 154, 157.
2. Ibid., p.37.
 3. Ibid.,
 4. Ibid., p.38.
 5. For example Brooks and Buckmaster (1976).
 6. Cyert and March.op.cit., p.37.
 7. Ibid., p.36.
 8. Ibid., p.37.
 9. Baumol and Stewart (1973), p.118.
 10. Cyert and March.op.cit., p.152.
 11. Ibid., p.157.