Managerial Discretion and Organizational Slack: A Commentary

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The central focus of this study is to analyse some important theoretical frameworks for understanding the phenomenon of managerial discretionary behaviour. The study suggests that the political - economy framework is useful in gaining insights into the modalities of managerial discretionary behaviour.

In this paper, Subhash Sharma further tries to decipher the implications of managerial discretion for explaining organizational slack.

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The development of a framework of discretionary behaviour requires a working definition of the term. However, a review of related studies shows that there is ambiguity about this term, as different authors define it differently. Gordon Tullock (1977) asks the same question: "What do we mean literally when we say 'management has certain discretion'? That 'management' is not completely constrained is clear: but how does 'management' make decisions as to how it shall use its discretion? Who decides who will get the ... secretary? Who indeed decides anything? What does the interior of the block-box look like? ... it is clear that some kind of collective decision process is going on... but what this collective decision process is does not seem to be clear" (p277).

Williamson (1964) has developed the notion of "expense preference" to explain the discretionary behaviour of managers. "By expense preference I mean that managers do not have a neutral attitude towards all classes of expenses. Instead, some types of expenses have positive value attached to them; they are incurred not merely for their contribution to productivity (if any) but, in addition, for the manner in which they enhance the individual and collective objectives of managers. Conventional economic theory treats all expenses symmetrically: individuals are indifferent towards costs of all types. Expense preference replaces this attitude of indifference by positive taste for certain class of expenses. Asymmetry thus develops in this attitude towards costs." Thus, Williamon's notion of expense preference indicates that managers display strong preferences for "who will get the... secretary?" The question is how the intensity of preferences can be incorporated in the economic models of the firm.

Management accounting theorists (Anthony, 1965) also attempt to probe the question of discretion. These theorists classify costs as engineered and discretionary. Engineered costs are the costs for which a formula (technical) relationship exists between the activity levels and costs. Discretionary costs are the costs for which a formula relationship does not exist. Managerial "expense preference" is usually hidden behind these types of costs. Therefore, discretionary costs offer opportunities for creation of organizational slack.
From the above discussion, it may be observed that managerial discretion implies a collective decision process in respect of resource allocation within the organization. Further, discretionary behaviour also implies "positive taste for certain class of expenses." It may also be pointed out that the question of discretion arises in a non-market context, because if markets can be allowed to operate, the need for discretionary behaviour will reduce.

**Theoretical Frameworks**

Two major theoretical frameworks that attempt to explain discretionary behaviour are the neo-classical theory of the firm and the behavioural theory of the firm.

**Neo-classical Theory**

In this theory of the firm, "... a hypothetical individual ... makes all decisions for the firm and is endowed with a range of idealized properties defining his knowledge, goals, computational skills and transaction costs" (Moe, 1984). This theory is based on a single valued objective function of profit maximization. On the basis of assumptions mentioned above about the hypothetical individual, this theory makes aggregate level predictions about output levels, prices and profits of firms operating under a given environmental context of perfect competition, monopoly and oligopoly. The strength of this theory lies in its predictive ability. Williamson (1964) criticizes its assumption but points out its predictive power: "Although descriptively false in detail, the assumptions may nevertheless be sufficiently accurate to permit the theory to handle a large class of circumstance of interest to economics." As noted by Friedman, a "theory should be judged by the empirical validity of its predictions, not of its assumptions." On the basis of this criteria, it can be stated that this theory of the firm provides a useful framework for making certain aggregative level predictions about output, prices and profits. However, the theory is not useful beyond these aggregative level predictions. Further, it assumes that managers have a "neutral attitude towards all classes of expenses."

Although the economic theory of the firm can handle "a large class of circumstances of interest to economics," it has often been criticized for its strong assumptions. Further, its focus is on the size of the black box, i.e., output levels, prices and profits, rather than on the internal processes within the black box. Here, a parallel can be drawn between Newtonian mechanics and Quantum mechanics. One of them looks at the phenomenon at the aggregate level, and the other attempts to explain internal processes. In a criticism of neo-classical theory, Moe (1984) notes: "The model firm is simply a black-box that produces optimal choices automatically as a function of any given environment."

**Behavioural Theory and the New Economics of Organizations**

During recent years, there has been a shift in economic theory toward analysis of inside processes within the black box. Cyert and March (1963), drawing upon Simon's work related to decision making, proposed a behavioural theory of the firm. This theory questioned the assumptions of the conventional economic model and attempted to develop "an empirically relevant, process oriented, general theory of economic decision making by a business firm" (Moe, 1984).

The roots of the "new economics of organizations" can be traced back to Coase's paper on "The Nature of Firm" (1937 and 1952). The central proposition of this paper is "that the higher the cost of transacting across markets, the greater will be the comparative advantage of organizing resources within a firm" (Krusselberg, 1986). Thus, this theory provides the rationale for emergence of "hierarchically structured organizations" as mechanisms that are more efficient compared to markets, in situations of high transaction costs. Once rationality for black boxes is established, the next question is to analyse the internal processes. Coase (1937 and 1952) notes that the inside of the organization presents us a non-market situation, because market transactions are eliminated inside the firm. He notes that "... in place of complicated market structure with exchange transactions we have the entrepreneur-coordinator who directs production" (p333).

It may be observed that the neo-classical theory of the firm is based on a "unitary model," i.e., it reifies the firm with a single rational actor. Further, in this model, "...all of the managers uniformly desire to see the firm operated so as to maximize profit (Williamson, 1964). The behavioural theory of the firm rejects this notion and observes that "...goals emerge over time in response to processes of coalition formation among organization members" (Moe, 1984).

Cyert and March (1963) also point out that individual goals and objectives of various coalitions within the organization are frequently at conflict with each other. Because of the inherent conflict of goals, different coalitions compete with each other for a dominant position. "Which goal is dominant depends upon the relative power and strength of that group within the internal polity" (Jackson, 1983). Since there is
continuing struggle between different coalitions about the organizational goals, the dominant goals undergo a change, if the current dominant coalition loses its relative power and strength. Further, the classical theory assumes complete clarity of goals. In reality, organizations display "goal ambiguity," i.e., lack of clarity of goals, because different members of the organization define and prioritize the goals differently. "Every one has his own idea of proper priorities in a just world. Thus, goals rather than being clearly defined and universally agreed upon are blurred and contested throughout the organization. If such is the case, then decisions taken on behalf of the organization as a whole are likely to reflect the goals of those who prevail in political contests, namely those with power in the organization" (Salancik and Pfeffer, 1977). Lack of clarity related to goals more often than not leads to goal disagreement. Figure 1 presents a model of the goal formulation process within organizations. This model directs attention to various factors that can contribute to goal disagreement and goal ambiguity.

Besides the various internal coalitions that compete for prioritization of goals, there also exist other interest groups that contribute to this prioritization. As the size of the organization increases, certain specific interest groups emerge. Thus, employees may organize themselves as an interest group. Further, managers as self-interested individuals seek to fulfill their personal goals. Thus, owners, managers, employees and at times the community at large constitute various interest groups. These interest groups are concerned with the question of "who gets what, when and how." Each group in its self-interest attempts to maximize its share of the pie.

**Political-Economy Framework and Managerial Discretion**

The political-economy framework takes into consideration the question of "who gets what, when and how." It also helps in understanding the underlying processes in decision making. Simon (1960), in his analysis of the decision making processes within organizations, introduced the notions of satisficing and bounded rationality. He classified decisions into structured and unstructured decisions. It has also been observed that decisions can also be classified in terms of uniqueness and multiplicity of solutions. Combining Simon's notion of structured and unstructured decisions and the notion about the nature of a solution, a 2x2 matrix can be developed as a framework to understand the internal processes within the "black box." It may be observed that unstructured decision situations require consensus of various parties that are likely to be affected. Further, situations of multiple solutions get resolved through "mutual adjustment" of various competing interest groups. An advantage of the markets is that they tend to generate unique solutions and thereby contribute to predictability. Unstructured situations and multiple solutions situations lead to discretionary behaviour. Figure 2 presents the various situations related to intensity of political activity in structured and unstructured decision situations.

As indicated in Figure 2, the unstructured decisions with multiple solutions are most appropriate for analysis of collective decision processes. Allison's (1971) analysis of the Cuban missile crisis indicates that different sub-units of bureaucracy compete for centre stage in collective decision situations. Further, each unit acts in its self-interest and accordingly influences the decision process in its favour.

Scott et al. (1978) have classified organizational decisions in terms of task level and institutional level. Task level decisions will usually be based on technical rationality and efficiency. Institutional level decisions are concerned with redistribution of gains and therefore equity considerations dominate in a collective process at this level. "At institutional level, decisions have to be..."
made allocating resources to various individuals, interest groups and economic sectors within organizations. These types of decisions ... set the terms and establish the distribution rules of who gets what and how much of organizational wealth'' (Scott et al. 1981). Since the pie can be divided in multiple ways, various individuals, interest groups and sub-units will act in their self-interest with a view to maximizing their utility. This process will necessitate a certain amount of consensus among various parties. "The point is that there are numerous ways in which this decision (cutting the pie) could be made, and different procedures will probably result in different amounts of consensus" (Scott et al. 1981).

The above analysis confirms Tullock's (1977) observation that "some kind of collective process is going on" inside the black box. Further, this decision process involves exercise of discretion. It is also observed that several organizational decisions need consensus. This in turn implies that a political process is going on inside the black box. Hence, the political-economy paradigm appears to be a more adequate framework to study the internal processes within organizations. Jackson (1983) notes that, "The general approach to the study of organizations embodied in the political economy paradigm has been suggested either implicitly or explicitly in writings of a number of disciplines."

In the above discussion, it was indicated that discretionary behaviour can be analysed using a political-economy framework. It may be observed that discretionary situations can be classified into two categories, namely the negotiated and the unstructured. The negotiated discretionary situations are those situations for which operating rules have already been drawn on the basis of a collective choice. The operating rules will define the leeway available to managers for decisions falling under their jurisdictions. Unstructured discretionary situations are those situations for which such rules are yet to be drawn. Our primary concern is with this type of discretion. Exercise of discretion in such situations involves a collective process, and managers in such situations attempt to optimize their unit's objective function.

It may also be observed that managerial discretion may get bounded due to competition among various interest groups. Once an initial solution is reached on the basis of collective choice process, the future discretionary behaviour gets constrained, because each party will use past information as a basis to enhance its self-interest and thereby constrain the discretion of others. An important implication of this proposition is that the political process within organizations tends to restrict discretion within certain limits. Thus, discretion gets bounded by precedents and by competition among interested parties.

Managerial discretion can be further constrained through close monitoring. However, any monitoring involves the cost of collecting information, and this cost increases rapidly for closer (higher) levels of monitoring. Figure 3 indicates the nature of the cost curve for various levels of monitoring classified as low, medium and high. However, because of information asymmetry, it may not be feasible to introduce closer levels of monitoring.
Implications for Organizational Slack

Managerial discretion may or may not be used for creation of organizational slack. However, it has been hypothesized in earlier studies that managers as self-interested individuals are empire builders and therefore they tend to create organizational slack (Williamson, 1964; Niskanen, 1971). Thus, organizational slack can be considered as an indicator of discretion. Earlier, it was observed that closer monitoring may eliminate some of the discretion and thereby organizational slack. Figure 4 indicates that at lower levels of monitoring the slack will be higher. As monitoring becomes tighter through information acquisition, the slack will decline. However, monitoring costs increase because of difficulties in getting information, and the opportunity cost of monitoring. In view of this, a certain amount of slack will have to be tolerated.

One way to reduce slack/discretion, is by allowing internal markets to operate. Lindblom's (1977) framework of politics and markets can be used to analyse the operation of internal markets and authority control. An organization can be calibrated on a continuum of authority control-market control scale. If internal markets can be allowed, the organization will be closer to a market control situation. A higher level of market control will tend to reduce slack. Slack will be at higher levels in authority control situations, and it will reduce as we move toward a higher level of market control. However, there are limits to the creation of internal markets and therefore a certain amount of slack will have to be tolerated as a cost in the context of non-market decisions. Figure 5 indicates the relationship between slack and intensity of authority/market control.

As organizations grow, there is incentive to acquire a larger slack. This is because, the growth stage represents a win-win situation and therefore managers/bureaucrats tend to cooperate in increasing their individual unit's slack and in the process contribute to increase in total slack. However, after reaching the limits of growth, there begins a phase in which there is competition to constrain slack. Figure 6 indicates that increase in slack can be represented as a logistic curve.

Though the overall slack increases according to the relationship indicated in Figure 6, the slack within individual units will vary according to the intensity of power wielded by that unit. Thus, sub-units that can exercise greater power will tend to acquire larger slack. Thus, for each sub-unit, the following relationship holds: Slack is directly proportionate to power intensity.

The analysis so far ignores the impact of uncertainty on managerial discretion and organizational slack. In order to understand this impact, it would be necessary to identify various situations of uncertainty. It may be observed that uncertainty may arise due to changes in the external environment as well as in the internal environment. The external environment can be classified as stable or unstable. Similarly, the internal environment can also be classified as stable or unstable. Using this classification, the relationship between uncertainty and slack creation can be presented in terms of a framework presented in a matrix in Figure 7.

It may be observed from Figure 7 that organizational slack is likely to be highest in situations of high instability both in the external as well as in the internal environment. High levels of slack in such situations arise because of two reasons: first, in uncertain situations monitoring becomes more difficult and relatively more costly because information is acquired more frequently. Second, managers will use slack as a buffer for coping with uncertainty as slack helps in uncertainty absorption.
Figure 4: Organizational Slack and Monitoring Costs

Figure 5: Slack and Intensity of Market Control

Figure 6: Slack and Organizational Growth
It may also be noted that goal disagreement or goal ambiguity is likely to be greater in situations of high instability in the external and the internal environment. The greater the goal ambiguity, the greater will be the tendencies towards empire building by the building of slack. Thus, organizations displaying greater goal disagreement are likely to have larger slack.

Another variable of interest in the study of organizational slack is managerial tenure. When a manager/bureaucrat joins an organization, his initial interest is in consolidating his position within the organization. Therefore, during the initial years, he is not likely to exhibit empire building tendencies. He may, in fact, attempt to reduce the slack or will keep it at the current levels. However, after the consolidation stage, he will depict empire building tendencies. Thus, managers with a longer career in an organization will create larger slack. Alternatively, given two identical bureaus, the one that has been headed by the same bureaucrat for a longer period would have more slack.

### Bibliography


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