Cut the Fat but Keep Some Slack

Why excess capacity leads to greater efficiency.

BY SENDHIL MULLAINATHAN
AND ELDAR SHAFIR
Still, slack is routinely undervalued. Perhaps you used to have an amazing administrative assistant always ready to do the tasks you needed on short notice. But he wasn’t always busy. In the interest of efficiency, the department was reorganized, and now you share the assistant with two other people. The office’s time-use data revealed this new system to be a success; now the assistant’s schedule is packed as tightly as yours. However, your last-minute requests can no longer be handled immediately. This means that with your heavy schedule, even the smallest shock sets you back. So you start to juggle, and fall further and further behind. The assistant had been an important source of slack. The fact that he was “underused,” like that room at St. John’s, is what made his role valuable.

When you have a lot to do, the standard impulse is to pack tightly to fit everything in. Otherwise, you are left feeling that you’re not doing enough—that you could be more efficient. But it’s a vicious circle. When your schedule is crammed, getting stuck in a traffic jam throws you into disarray. You are late to meeting number one, and with no time in between meetings, that delay pushes into meeting number two, and so on. You finally have no choice but to defer one of today’s obligations to tomorrow, except, of course, that tomorrow’s schedule is packed too, and the cost of that deferral ends up being high.

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managers must negotiate diligently with suppliers and scrutinize every line item to decide whether an expense is truly necessary. This kind of focus is easier to come by under scarcity and harder to come by under abundance. Even private companies, whose managers are spending their own money, start acting “fat” when awash in cash.

As we have seen, slack can represent a source of great (though often hidden) value or it can represent waste. When slashing costs and reorganizing for efficiency, it can be hard to separate useful slack from true waste, and indeed, many of the leveraged companies of three decades ago were left at the brink of bankruptcy. Faced with that reality, they tunneled—they neglected everything besides the emergency at hand. Cut too much fat, remove too much slack, and you are left with managers who will mortgage the future to make ends meet today.

Cut the Fat Carefully
Now, let’s look at slack through a different lens. During the 1970s and the early 1980s, there was a widespread perception that many corporations were bloated. Some industries were so awash with cash that executives spent carelessly. Because of poor cash management, in fact, several oil companies were worth less than the oil they owned; the market anticipated they would simply waste their assets. The leveraged buyout wave in the 1980s was an attempt to solve this problem.

The logic was simple: Buy these companies and impose pressure by placing them in debt. Move them from abundance to scarcity. The discipline of debt—in our parlance, the focus that comes from scarcity—would improve performance. And a raft of empirical studies showed that, whatever their other consequences, leveraged buyouts did just that. One reason was that corporate fat gives some managers added incentive to spend poorly—even spend in ways that run counter to shareholders’ interests. After all, it’s someone else’s money. By increasing leverage and reducing what is effectively free money, managers spend more wisely.

Leverage also had an effect because of the psychology of scarcity. Companies became “lean and mean,” in part, for the same reason deadlines produce greater productivity. Being a hypervigilant manager who keeps costs low can require a great deal of cognitive effort. Such managers must negotiate diligently with suppliers and scrutinize every line item to decide whether an expense is truly necessary. This kind of focus is easier to come by under scarcity and harder to come by under abundance. Even private companies, whose managers are spending their own money, start acting “fat” when awash in cash.

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Understanding the logic of scarcity and slack can reduce the firefighting mentality. Consider the lesson of how banks have tried to manage risk. Banks have long recognized that managers, tunneling on the bottom line, do not sufficiently take risk into account (perhaps best demonstrated by the 2008 financial crisis). Many banks have introduced “chief risk officers,” who sit apart from the rest of the management team and report directly to the CEO. They must approve financial products, loans, and other transactions, viewing them through the lens of risk.

Other organizations can take a similar approach to “slack management.” Designate someone (or a team) to focus not on what needs to be done today but on the possible events that could disrupt your business tomorrow. This person or group can ensure that those who are focused on meeting immediate project targets are not borrowing from future projects, digging the organization deeper into a bandwidth hole.

It is no coincidence that the advisor who proposed the shakeup at St. John’s was an outsider, removed from the struggle for the next operating room.

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This article was adapted from Mullainathan and Shafir’s new book, Scarcity: Why Having Too Little Means So Much (Times Books, 2013).