

Behavioural Theory of the Firm

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ABSTRACT:

In the study of organizational economics and management, the Behavioral Theory of the Firm (BTF) is a fundamental theoretical framework. An overview of the BTF's main ideas, tenets, and consequences for comprehending organizational behavior and decision-making are explored in this abstract. The typical neoclassical economic theory, which makes the assumption that businesses are logical, profit-maximizing entities, is disregarded by the BTF. Instead, it acknowledges that people inside organisations have confined rationality, constrained information processing capacities, and a range of preferences. These cognitive biases and human limitations affect how businesses operate and make choices. This abstract explores the fundamental ideas of the BTF, including satisficing behavior, organizational practices, and making decisions in the face of ambiguity. It emphasizes how crucial it is to comprehend how interpersonal connections inside a company shape organizational behavior and how cognitive and social elements affect employees' decisions. The abstract also emphasizes the importance of using the BTF in numerous organizational situations, including corporate governance, innovation, and strategic management. It looks at how the theory may be used to explain things like route dependence, inertia, and organizational learning, giving practitioners and academics insightful information. The BTF's shortcomings and detractors are also looked at. Some contend that the theory lacks precise predictive power and is difficult to operationalize in empirical study, despite the fact that it provides a more realistic representation of organizational behavior.

KEYWORDS:

Organizational, Learning, Performance, Research Study.

I. INTRODUCTION

The Behavioral Theory of the Firm (BTF), in contrast to conventional economic theories, does not assume that businesses are irrational beings out to maximize profits. The BTF, which was created in the area of organizational economics, recognizes the impact of human behavior, cognitive constraints, and limited rationality on organizational decision-making processes. It offers a more sophisticated and realistic knowledge of how businesses function and make decisions under challenging circumstances. According to traditional economic theory, people and organisations make rational choices by carefully analyzing all available information and aiming to maximize their utility or profits. By acknowledging that decision-makers inside organisations often experience cognitive constraints, such as information overload and the inability to digest all relevant facts, the BTF contradicts this assumption. As a consequence, individuals engage in "satisficing" behavior, attempting to make "good enough" judgements as opposed to aiming for the best possible results[1], [2].

We shall examine the main ideas and tenets of the Behavioral Theory of the Firm in this introduction. We will talk about how cognitive biases, heuristics, and constrained rationality affect how people and groups make decisions in organisations. Additionally, we will emphasize the importance of organizational practices and training in influencing organizations' behavior over time. The BTF emphasizes that groups of people inside an organisations are not homogeneous beings but rather have their own preferences, worldviews, and cognitive constraints. Within the organisations, these people

interact and work together, which promotes the development of organizational routines and behavioral patterns[3], [4].

We will also go through the ways in which management and economics have used the Behavioral Theory of the Firm. The BTF gives useful insights into comprehending the dynamics of actual organisations, from corporate governance and organizational design to strategic management and innovation. The BTF has endured obstacles and criticism despite its efforts. Some claim that its use is limited by its lack of accurate forecasting capability and the challenge of operationalizing its notions in empirical study. The theory's proponents argue that these drawbacks are outweighed by the focus it places on human behavior and practical decision-making procedures. An invaluable foundation for comprehending the intricacies of organizational behavior is provided by the Behavioral Theory of the Firm. The BTF presents a more realistic and nuanced perspective of how organisations function by acknowledging the importance of human behavior and cognitive limits in decision-making. Managers and policymakers may create more successful organizational plans and practices that are in line with the behavioral inclinations of people inside the company by having a better understanding of the BTF's guiding principles and consequences. Additionally, it provides academics with a conducive framework for investigating and improving our knowledge of organizational behavior and decision-making in a variety of dynamic corporate situations[5], [6].

II. DISCUSSION

The study tradition known as the behavioral theory of the firm (BTF) expands and develops the concepts presented in Richard Cyert and James March's 1963 book *A Behavioral Theory of the Firm*. An important presumption in this research is that managers are bounded rational, which implies they may not be able to completely anticipate the outcomes of certain actions or may not have fully developed preferences for the outcomes. Its core idea is that managers will behave differently from how rational actor views of the organisations would predict, both in terms of internal organizational choices and control and in terms of relationships between the organisations and its environment. Thus, it tried to provide an empirically based, process-oriented explanation of how choices are really made as a corrective to rational actor interpretations of the organisations. Its original focus was on the most crucial organizational choices made by corporate organisations, such as those relating to production, pricing, and inputs. However, over time, its scope has grown to include the majority of organizational decisions, and it is now being used by non-profit organisations. BTF made a number of additions to prior work by March and Herbert Simon that had defended the significance of individual bounded rationality and organizational structures as instruments for comprehending decision-making. BTF, its progenitor, and any related works are collectively referred to as the Carnegie School. The foundations of the theory are explained in this entry, which is followed by a short overview of its development and significance for the discipline of organisations theory.

Fundamentals

Cyert and March's 1963 book, "A Summary of Basic Concepts in the Behavioral Theory of the Firm," which covers the three core ideas (state variables) and four relational concepts (change processes), has served as the foundation for most of the BTF research. Organizational objectives, organizational expectations, and organizational choice were the three key ideas. Organizational goals, which are not always included into a consistent goal system, are aims for the organisations that are developed by negotiation among members of the dominant coalition running the organisations. The projections of future situations made by organizational members based on their past experiences are known as organizational expectations. Organizational decisions are made by comparing potential solutions that are successively found via search to levels that satisfy target variables (also known as satisfying). These three fundamental ideas form the basis of an organizational decision-making process that requires significantly less cognitive and communicative effort than fully rational models. It also allows for different organizational members to satisfy a variety of goals and expectations, and it allows the organisations to focus on various objectives at various points in time[7], [8].

In the paradigm, quasi-resolution of conflict, avoiding ambiguity, problematic exploration, and organizational learning were the relational notions that drove action. Instead of making explicit trade-offs, quasi resolution of conflict refers to the taking of actions that have an impact on many objectives in order to adhere to limitations of minimum acceptable performance on each goal. With uncertainty avoidance, managers try to influence the environment via negotiation and respond to unforeseen issues rather than overtly forecasting uncertainty in the environment. Searching for solutions "near" the symptom of the issue or the existing condition of the organisations is referred to as problematic search and is a response to performance below the aspiration level on a target variable. Organizational learning is the modification of objectives, focus, and search strategies as a consequence of knowledge obtained by making adjustments. The model is one overall, of managers trying to respond wisely to difficulties they face, but in a piecemeal way that gradually transforms the organisations and does must be in the direction of an ideal condition. The principles introduced in BTF have been used in a variety of management research projects[9], [10].

For instance, the theory of intraorganizational power, which has ramifications in studies on resource reliance and criticality as sources of power and on the capacity of powerful units in the organisations to resist change, includes goal negotiation as a key component. These are the basis of the resource dependency hypothesis. Research on management ambitions for performance, often known as performance feedback theory, places a lot of emphasis on organizational expectations and problematic search. The point dividing performance that is perceived as a problem from performance that is considered as acceptable is characterized in this study as the aspiration level, which is a source of anticipated performance. According to research on managers' ambitions, aspirations are regularly updated according to norms that are very similar to those proposed by Cyert and March, and changes have been seen to take place at intervals that are compatible with problematic search predictions. Major research traditions employ combinations of BTF principles, such as the usage of limited rationality and uncertainty avoidance as fundamental presuppositions of institutional theory, which results in the prediction of copycat behavior among organisations. Resource dependency theory predicts that organisations would try to co-opt and manage surroundings to avoid making disruptive adjustments in response to environmental demands. BTF makes a similar prediction.

Evolution

The 1963 book by Cyert and March, written for a seminar on organisation theory, has two results: It did two things: it established the framework for BTF research and it presented essential ideas that have been utilised both directly and indirectly to inform other types of study. Some study traditions are of particular relevance since they directly address the agenda of BTF, despite the fact that there are many impacts from major principles in BTF to contemporary theory. A fundamental finding from the BTF is the notion that organisations learn from their experiences by permanently altering their behavioural patterns. This theory has sparked research on organisational learning, which has spawned a variety of subfields. According to some academics, an organisational memory exists in the form of organisational culture, work procedures, and networks in addition to individual memories. These researchers wonder how organisations keep the lessons learned from prior events. Others have studied aspects of the environment including complexity, closeness to other organisations with similar missions, and competitive structure in order to understand how various types of experience affect learning. The study of how businesses might benefit from their founders' experiences is part of this research. Others search for "momentum" effects, which cause prior changes to be repeated because they are still prominent activity patterns in the organisation, while others look for how learning from one's own experience impacts later actions. The idea of standard operating procedures was created by BTF, and it includes everything from particular routines for carrying out tasks to routines for management decision-making. Later research focused on task routines and created routines as a fundamental organisational learning item. The evolutionary theory, which investigates how progressive selection and change of routines might result in organisational building of capacities, is based on the findings of this study. It actively contributes to theories on knowledge transmission, use, and acquisition in strategy research, which is interested in the issue of how organisations might exhibit enduring performance disparities.

The resource-based concept develops the notion that organisational learning from experience, encoded into routines that may be difficult to transmit or even express, may provide a solution. Combining the notions of routines as the subject of learning and problematic search as the method of learning results in a prediction of incremental modifications in response to problems, producing the performance increases at a diminishing pace found in learning-curve research. Additionally, the impact of organisational boundaries on the learning curve is examined in this article. The fascination in routines has also given rise to a legacy of study that looks at how routines are created and changed, often by direct field observation, but experiments and inference from performance consequences are also utilised. This study demonstrates that routines are surprisingly durable yet may alter according to a variety of events, including BTF processes like *asas* an esoteric search. An associated research tradition investigates how organisational challenges, the development of rules, and competition all affect how organisational rules emerge, persist, and evolve. a set of laws. When it comes to routines research, Martha S. Feldman and Brian T. Pentland have made significant contributions, while Linda Argote has played a major role.

By determining whether organisational performance below the ambition level results in changes like new market behaviours and the introduction of innovations, research on performance feedback has directly explored problematic search. The idea is connected to research on how organisational reference groups are established by resemblance, status, or network linkages in this work since it implies impact from other organisations in the adjustment of the ambition level. Conversely, it has been shown that changes in network connections are also a consequence that are influenced by problematic search since network linkages with other organisations serve to stabilise the environment. Numerous studies have connected BTF and prospect theory by fusing problemistic search processes with analyses of management risk taking. It has mostly focused on choices at the organisational level, although more recent research has demonstrated evidence for problematic search on unit-level outcomes like operational safety. This study also investigates the BTF's claim that organisations seek when their resources are few.

Testing if the performance feedback process from performance to change also involves a rapid decline in the likelihood of change beyond the ambition level, as problematic search would predict, is an important component of the task, particularly in organisations that change only somewhat more easily than average. It has produced a lot of data to back up the BTF claims. This study has benefited greatly from the contributions of Henrich R. Greve. The BTF method of quasi-resolution of conflict has prompted research into how organisations create objectives and use them in certain circumstances. In contrast to the work on performance feedback, the emphasis here is on how a goal or collection of objectives becomes significant in a given context rather than how an organisation responds to a particular goal. A portion of this research chooses particular settings for the study of political behaviours, such as the politics of senior managers or of the CEO and the board of directors. Another section looks at how the decision-making context affects how the firm's decision-makers pay attention. The performance feedback mechanism and attention theory may be paired to demonstrate sequential attention to objectives, as anticipated by the BTF, and they can also be used to extend the BTF's purview to areas like management cognition. To this study, William Ocasio has contributed crucial contributions.

Examining the effects of the organisational learning brought on by the different processes suggested was a key issue in BTF. This has given rise to a significant body of research utilising simulations to explore additional BTF components as well as the adaptive effects of problemistic search in various resource situations. The tradeoffs between various learning processes are the focus of the major contributions in this field. Organisations concurrently learn to do tasks more effectively and to choose between other tasks, and quick learning of execution might result in the selection of in the long term inferior alternatives. When the organisation is modelled as a collective actor as opposed to a unitary one, a distinct form of this trade-off is evident. Organisations socialise their members into the most prevalent views in the organisation while also learning from the different opinions of its members. Rapid socialisation prevents possibilities from being discovered; this is known as the exploration/exploitation trade-off. It could be typical to see organisations utilise more exploitative

tactics than exploratory ones since many organisational systems promote consistency of thought and behaviour. In empirical research as well, the trade-off between exploration and exploitation has grown in significance. The modelling tradition has recently been broadened to look at the effects of decision rules with foresight, such as when a decision maker already knows which course of action is the best. Daniel A. Levinthal and James G. March have both made significant contributions to this study.

Importance

BTF is still highly active today in the shape of a core group of research traditions that continue and expand on its fundamental ideas and procedures. In areas like organisational learning from others' experience, organisational routines, organisational attention, performance feedback, and adaptability, there has been substantial theoretical and empirical improvement. There is a very strong empirical record of support, as one would anticipate from a theory based on an observational, process-oriented approach of organisational decision making. It may surprise you to learn that so much of this evidence supports a hypothesis recently. Despite its antiquity, this is due to the straightforward methodological fact that the theory primarily provides predictions about the possibility of changes under certain circumstances, necessitating the use of dynamic analytic approaches, which only appeared in organisational research in the 1980s. The main processes mentioned above are now considered to be essentially established, and research is moving on to elaborations like introducing conditions that moderate the effects, examining particular mechanisms like sequential attention to goals, and discovering contextual effects like new outcomes that are affected by the theory or new contexts that have not previously been examined. The hypothesis is so complete that numerous unanswered topics continue to draw attention from researchers.

Its processes for how organisations develop ring true while having unexpected repercussions for organisational change and adaptation, which is one reason it is still such an active source of research ideas. Many of these mechanisms are still worthwhile study objectives today because new data sources or improvements in technique enable studies that were not feasible when the BTF was first proposed. In addition to the research that is unmistakably in the BTF lineage, it has also injected ideas and procedures from other theories into the more expansive domains of organisation theory and strategy. Thus, it has a wide impact on other types of research and a limited impact on research that directly advances its core aim.

Since BTF is intimately tied to how choices are made in organisations, it has produced a number of results with obvious management implications. Numerous of these relate to the function of leadership in organisations and shaped the leadership course that James G. March taught for 25 years to Stanford MBA students. In addition to March's 1994 book on decision-making (see Further Readings), which was based on the lecture notes and co-authored with Thierry Weil, which was subsequently published, both books are highly recommended for their instructional value. A key finding of BTF is that organisations are adaptive systems that will choose their own course with just little administrative input, even if these courses are not always the best.

In this way, organisations built to quickly socialise members may miss out on opportunities to learn which strategy is the best, organisations built to quickly learn how to execute strategies may miss out on opportunities to do so, organisations looking for consistent strategies may lose out on opportunities to learn which strategy is best, and so on. All of these trade-offs have significant effects on performance and survival, and many go against conventional managerial wisdom. Organisations also don't submit to their leader's wishes as readily as conventional management counsel suggests. Goal proliferation may result in inactivity, whereas goal concentration has undesirable side effects, which is a challenge in attempts to regulate organisations using goal systems. An excessive focus on flexibility works against the propensity of organisations to establish and enhance routines, while attempts to control organisations via explicit rules and routines cut off the improvement chances in making the routines grow. Overall, BTF advises that leadership be applied with tact and a thorough understanding of the real processes used to make organisational choices.

III. CONCLUSION

A persuasive and enlightening viewpoint on organisational behaviour and decision-making is provided by the Behavioural Theory of the Firm (BTF). The BTF offers a more realistic and nuanced picture of how organisations function in complex and unpredictable situations by taking into account the influence of human behaviour, constrained rationality, and cognitive limits. We have examined the BTF's fundamental ideas throughout this examination, including satisficing behaviour, constrained rationality, and the impact of organisational procedures. We have seen how these ideas shed light on how organisations make decisions, realising that people often confront information overload and are not always able to make entirely logical decisions. Instead of aiming for optimality, individuals instead engage in satisficing behaviour, seeking results that are agreeable.

Additionally, the BTF emphasises the significance of organisational routines, which result from the group activities of people inside the company. These practises have the potential to create route dependence and inertia, which over time may change the way an organisation behaves. The idea also highlights how important learning and adaptation are for organisations as they adjust to new situations and experiences. The BTF has been used successfully in a number of management and economics fields. Understanding the cognitive constraints and behavioural biases of decision-makers aids in developing more successful tactics in strategic management. The BTF provides insights into the elements that affect innovation in terms of how new ideas are adopted by organisations. The idea also has ramifications for organisational structure and corporate governance, which will enhance procedures and better reflect human behaviour. The BTF is not without criticism, despite its contributions. Some claim that its practical applicability is limited by its lack of exact forecasting capacity and the difficulties associated with empirical study. It's crucial to note that the BTF's strength resides in giving readers a deeper grasp of actual organisations by taking into account the complexity of human behaviour.

To sum up, the Behavioural Theory of the Firm is an important theoretical foundation that extends and complements conventional economic theories. The BTF provides managers and decision-makers with invaluable insights for creating more successful and adaptable organisations by taking into account the human elements of decision-making and organisational behaviour. The BTF's focus on human behaviour and cognitive limits will become more and more relevant for comprehending the dynamics of organisations and their reactions to a constantly changing environment as the business landscape continues to change. Businesses may better negotiate complexity and uncertainties by incorporating the BTF's teachings into organisational practises, which will eventually result in greater performance and long-term success.

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