Daniel Simonovich,
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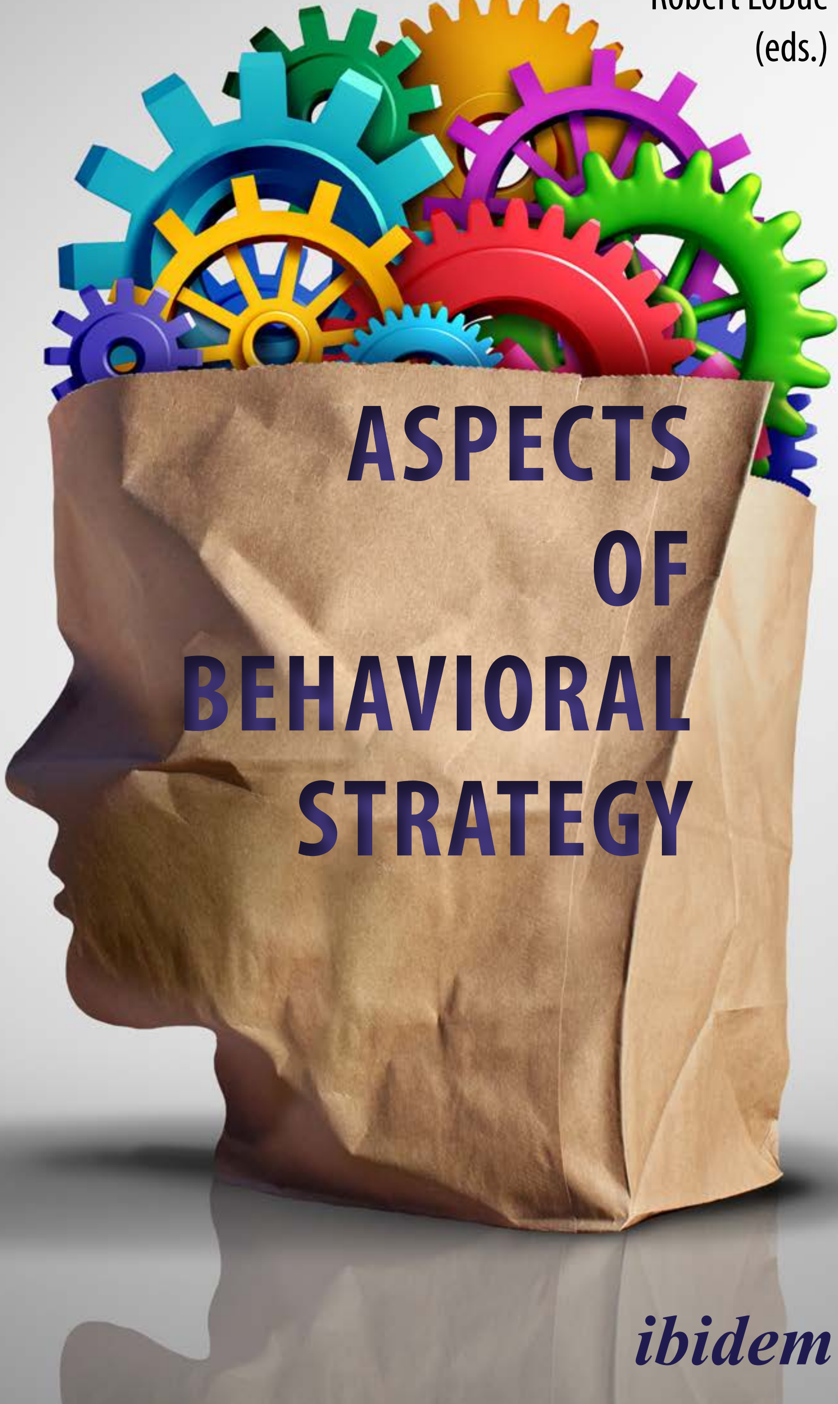
(eds.)



ASPECTS OF BEHAVIORAL STRATEGY

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Introduction

In the dynamic world of modern business, strategy-making has witnessed profound shifts. Gone are the days when strategy was solely governed by stringent analytical models. Today, there's a burgeoning recognition of the role human behavior plays in shaping strategic choices and outcomes. "Aspects of Behavioral Strategy" is a testament to this evolution, offering readers an in-depth exploration of how behavioral insights are entwining with traditional strategic paradigms, reshaping them for the complexities of today's organizations.

This book is the collective brainchild of graduate students and alumni from ESB Business School of Reutlingen University, enriched by contributions from the school's faculty and from INSEAD. With this diverse set of authors, the content presents a blend of academic rigor and practical relevance, making it an invaluable resource for business students, scholars, practitioners, and anyone interested in the nexus between strategy and human behavior.

Part I: Foundations of Behavioral Strategy establishes the foundational pillars of behavioral strategy. Here, readers are introduced to the behavioral theory of the firm, unearthing the intersections of social psychology and cognitive frameworks with strategic practices. As we navigate the turbulence of VUCA (volatile, uncertain, complex, and ambiguous) environments, the significance of cognitive processes in strategic management becomes evident. This section further explores the realms of strategic decision-making, organizational learning, and system dynamics, laying the groundwork for this nascent discipline.

Venturing into **Part II: Tools and Techniques in Strategy**, the spotlight is cast on the continually evolving methods and approaches within strategy. This section invites readers to trace the evolutionary trajectory of strategic tools, grasp the intricacies of formulating and evaluating strategic choices, and familiarize themselves with the "simple rules" approach in strategy. The emphasis throughout is on strategic tools that are attuned to the imperatives of human behavior.

Part III: Further Topics in Behavioral Strategy immerses readers in specialized facets of behavioral strategy. This section dissects the interplay between emotions and strategic initiatives, highlighting the powerful emotional undertows that can either bolster or hinder strategy execution. Moreover, the promising confluence of neuroscience and strategic management is unveiled, suggesting intriguing avenues for future research. The section rounds off with a deep dive into behavioral game theory, underscoring its pivotal role in strategic decision-making scenarios.

In "Aspects of Behavioral Strategy," you are not just exploring strategy; you are embarking on a journey where strategic models intertwine with the complexities of the human psyche. We invite you to delve into these pages and enrich your understanding of strategic management in the contemporary business milieu.

Welcome to a world where strategy resonates with the human essence.

Daniel Simonovich
Robert LoBue

Part I:
Foundations of
Behavioral Strategy

Behavioral Theory of the Firm

Robert LoBue, Constanze Peters and Simona Rabuzin

Abstract. This article discusses the behavioral theory of firms and how it lays the foundation for behavioral strategy, which combines elements of social psychology and cognitive frameworks with strategic management principles and practices. The goal is to highlight key contributions from various authors by comparing their work. Emphasis is placed on the behavioral theory of firms and its significance to behavioral strategy that integrates social psychology and cognitive aspects with strategic management practices. However, this area of study is still relatively untapped, and more research is needed to develop comprehensive approaches.

Keywords: behavioral theory of the firm, behavioral strategy, behavioral research, organizational decision-making, bounded rationality, cognitive psychology

1. Introduction

Many publications in the fields of strategy and organizational theory have incorporated important concepts of the behavioral theory of the firm as a theoretical basis. Several authors have already addressed implications of the behavioral theory of the firm extensively, for example, in the fields of behavioral finance and behavioral economics (Barber, Heath & Odean, 2003; Nelson & Winter, 1982; Williamson, 1996). However, limited research has examined the importance of the behavioral theory of the firm for behavioral strategy and how this theory has influenced the overall field of strategy. Therefore, the article at hand examines central ideas of the behavioral theory of the firm and its impact on the general field of organizational dynamics, with a specific focus on behavioral strategy.

The examination begins with the following section, where the behavioral theory of the firm is defined and evaluated. Thereafter, the field of behavioral strategy is critically analyzed including its definition and different streams of research. Furthermore, on the basis of this analysis, the behavioral theory of the firm is linked to the topic of behavioral strategy, while the implications of the behavioral theory of the firm for behavioral strategy are examined in detail. Finally, research gaps are defined to identify further areas of study to potentially widen the field of attention in this topic.

2. Outline of the behavioral theory of the firm

A number of recent scholars, including Argote & Greve, 2007; Gavetti, Levinthal, & Ocasio, 2007; and Gavetti, Greve, Levinthal & Ocasio, 2012, emphasized the importance of the behavioral theory of the firm for organizational theory, as applied to general organizational phenomenon, as well as strategic management. In the following, a brief introduction to behavioral theory of the firm and its historical background is given.

2.1. Historical development of behavioral theory of the firm

According to Bāleanu (2007), the impetus for development of the behavioral theory of the firm stemmed from the seminal works of H. A. Simon in the middle of the past century, his book *Administrative Behavior* in 1947 and his article "A Behavioral Model of Rational Choice" in 1955. Gavetti and Levinthal (2004) stated further that many contemporary strategic implications of the theory are contingent on the follow-on books *Organizations* by March and Simon (1958) and *A Behavioral Theory of the Firm* by Cyert and March (1963). As a consequence, these contributions have set the cornerstone for the behavioral theory of the firm. These academic works are also often considered as having formed the early "Carnegie School conceptions", which were built on three assumptions: "organizations as the ultimate object of study, decision making as the privileged channel for studying organizations, and behavioral plausibility as a core principle underlying theory building" (Gavetti et al., 2007).

In general, the behavioral theory of the firm has a high significance for the overall field of behavioral and organizational theory (Augier, 2013; Augier & March, 2008; Argote & Greve, 2007). However, the behavioral theory of the firm did not only establish one single theory, but, until today, numerous behavioral and organizational theories, all treating different aspects of the firm, have been influenced by the concept of behavioral theory of the firm (Argote & Greve, 2007). Thus, by reason of its very open nature, the concept of the behavioral theory of the firm allows scholars to build on these multiple ideas of the behavioral and organizational theories and develop them further (Miner, 2015). It is hence considered to be a very broad-based theory (Argote & Greve, 2007). However, the core element of the theory has remained the same over the course of time, which is "a behaviorally grounded approach that treats bounded rationality, adaptive processes, and unresolvable goal conflict and ambiguity as foundational" (Gavetti, et al., 2012). In the following, a definition of the behavioral theory of the firm is presented.

2.2. Definition of the behavioral theory of the firm

While the behavioral theory of the firm is a very broad concept, consisting of multiple and varying aspects, its main premise was predominantly shaped by March and Cyert (1958) and has been employed by many different scholars over the subsequent years (Augier, 2013; Maslach, Liu, Madsen & Desai, 2015; Gavetti & Levinthal, 2004). Originally, the theory was developed as a critique of organizational theory and "viewed macro-level phenomena, such as price setting and resource allocation, as stemming from fundamental decision processes carried out by individuals within organizational entities" (Maslach et al., 2015). It remains a concept that "opens up the black box of the firm and accumulates theory and evidence on how a firm behaves as a result of lower-level processes, possibly involving individuals and groups, and certainly leading to observable decisions on economically important variables" (Gavetti et al., 2012).

The behavioral theory of the firm has been hence constructed on "organizational goals, a bounded rationality conception of expectations, an adaptive conception of rules and aspirations, and a set of ideas about how the interactions among these factors affect decisions in a firm" (Augier & Teece, 2009). Whereas the central idea behind the behavioral theory of the firm is, that a company is no longer viewed as a "mono-objective/mono-decision" entity, as it has been seen in traditional frameworks, but it is rather considered as a "multi-objective/multi-decision" entity where groups such as employees, suppliers, managers, customers, as well as shareholders comprise the entity of the firm (Bāleanu, 2007). Each of these groups possesses its individual demands and interests, consequently leading to conflicts, for example, regarding the allocation of a company's resources (Augier & March, 2008; Bāleanu, 2007).

An underlying concept of the behavioral theory of the firm has been the belief that decisions in a firm are intended to be rational but, due to human and organizational limitations, will never be completely rational. Therefore, a crucial assumption has also been that a firm consists of bounded rational individuals and groups (Simon, 1995; Cyert & March, 1963; Blume, Duffy & Franco, 2009) and that decision-making in firms is dependent on finding a satisfying solution rather than looking for the best possible solution (Cyert & March, 1963). While previous research into the workings of the decision-making process had confirmed and emphasized the importance of a standard procedure for recurring decisions (Allan, 1966), this implied that managing an organization involved handling bounded rationality in a developing business setting (Dew, Read, Sarasvathy & Wiltbank, 2008) and adapting its future strategies and objectives with regard to already gained experience (Augier & March, 2008). This suggested that organizations can learn new objectives, which contrasts with the prevailing opinion that organizations have unchanging values and strategies (Miner, 2015).

As seen in the above-mentioned analysis, the original works by Cyert and March (1963) and by March and Simon (1958) presented a particularly influential concept that still impacts scholars and the directions of their research. In particular, the fields of behavioral economics and behavioral finance have been strongly influenced by the behavioral theory of the firm. In behavioral finance, topics such as the investment behavior of groups vs. the investment behavior of individuals have been assessed (Barber et al., 2003). Fundamental economics concepts such as evolutionary economics and transaction cost economics have also been influenced by the behavioral theory of the firm (Nelson & Winter, 1982; Williamson, 1996). More recently, the topic of behavioral strategy has received increasing attention and has been discussed more frequently in academic literature. However, behavioral strategy has not yet been developed to the same extent as behavioral economics and behavioral finance. Hence, an overview of behavioral strategy is presented below and, afterwards, it is linked to the behavioral theory of the firm.

3. Overview of behavioral strategy

At this point, the term strategic management needs to be clarified since it is a fundamental component of understanding behavioral strategy. Early research was performed in the 1960s and 1970s where scholars such as Anshen and Guth (1973) and Meyer (1978) shaped the theoretical background of strategic management and established sub-topics, such as: strategy concept, evaluation, content, implementation, management process, board of directors and general management roles, and new ventures (Ronda-Pupo, 2015).

Indeed, along with the behavioral theory of the firm (Cyert & March, 1958), strategic management has been influenced by many different behavioral streams of research, such as behavioral decision research