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BEHAVIORAL DECISION THEORY AND BUSINESS POLICY

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ABSTRACT

Theoretical and empirical work in Behavioral Decision Theory can enrich the traditional business policy course. Business policy should integrate normative and descriptive theories of individual and organizational behavior. One means of accomplishing this objective is to view policy formulation and implementation as a series of key strategic decisions made under conditions which vary from certainty to ambiguity.

POLICY AND THE DILEMMA OF RATIONAL CHOICE

Recent advances in the field of Behavioral Decision Theory pose a dilemma for teachers and students of business policy. On the one hand, there are growing social demands for accuracy, fairness and account- ability in policy making both for business and governmental organizations. These pressures compel managers and administrators to adopt increasingly objective, rationalistic and formalized procedures to insure that policies regenerate sound choice. On the other hand, there is growing evidence that individuals have severe limitations in their ability to process information and generate optimal solutions to problems. Recent research summarized by Wright [4] strongly suggests that individuals use heuristics to simplify their cognitive information processing requirements. Steinbruner [3] argues that cognitive mechanisms generate organizational policies that cannot be accounted for by rationalistic norms. This discrepancy between social expectations for sound choice and actual performance in planning and policy making creates a dilemma; either the policy maker must openly violate rational norms and face outraged consumers or constituencies, or must place a premature, and often unwarranted, emphasis on formal methods which paradoxically may undermine the efficacy and legitimacy of management [2].

STRATEGIC DECISION MAKING STRATEGIES

A partial resolution of the dilemma of having to make rational decisions in the context of cognitive limits and organizational constraints is to conceive strategic choice as occurring in one of four conditions.

DECISION CONDITION	OUTCOMES OF CHOICE	PROBABILITIES OF OUTCOMES	APPROPRIATE STRATEGY
Certainty	Known	Known and equal to 1	Value Consensus
Risk	Known	Known	Expected Utility
Uncertainty	Known	Unknown	Experimentation
Ambiguity	Unknown	Unknown	Problem Creation

When outcomes are known and prediction is close to perfect, the policy maker must simply insure goal consensus and act. When prediction is far less than perfect, the policy maker can act rationally by following the dictates of expected utility theory. uncertainty is the condition of known outcomes but unknown probabilities associated with each outcome. Here the appropriate course is to experiment in order to generate probability estimates. Finally, ambiguity is the condition of unknown outcomes, in which case techniques of management science and rational decision must give way to the operation of "sensible foolishness" [1] until the problem can be more clearly defined and Outcomes identified.

Thi8 conceptual scheme allows both descriptive and normative theories to be discussed under one rubric. Normative decision theory forces the policy maker to consider the future by specifying potential outcomes associated with choice, assessing the probabilities associated with each outcome, and selecting the strategy is most likely to produce a future consistent with value preferences. Any strategic choice may be optimal with a given set of distinct outcomes and associated probabilities, but nonetheless turn out to be a failure. However normative decision theories assume at least conditions of uncertainty and most often posit conditions of risk. Descriptive theories, on the other hand, offer a reasonably consistent set of generalizations about how individuals actually make decisions, e.g. through negotiation, simplifying heuristics, satisfying and retrospective rationalization. This behavior makes sense when outcomes are indistinguishable, preferences are fluid, and the linkages between actions and outcomes are problematic.

SUMMARY

The business policy course should be designed to advance student understanding of strategic choice behavior. An examination of the relationship between the formal characteristics of a choice situation and appropriate strategies for decision making reveals that both normative and descriptive theories of choice behavior can be reconciled. Policy generation can be viewed as an effort to move the context of choice from a condition of ambiguity to the more favorable conditions of uncertainty, risk, and ultimately, certainty.

REFERENCES

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[2] Landau, Martin and Stout, Jr., Russell. "To Manage Is Not To Control: Or the Folly of Type II Errors," Public Administration Review, Vol. 39, 1979, pp. 148-156.

[3] Steinbruner, John D. The Cybernetic Theory of Decision (Princeton: Princeton University Press, 1974).

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