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Introduction

This book is about the business firm and the way it makes economic decisions. We propose to make detailed observations of the procedures by which firms make decisions and to use these observations as a basis for a theory of decision making within business organizations. Our articles of faith are simple. We believe that, in order to understand contemporary economic decision making, we need to supplement the study of market factors with an examination of the internal operation of the firm – to study the effects of organizational structure and conventional practice on the development of goals, the formation of expectations, and the execution of choices.

The rationale for such a belief is also simple. The modern "representative firm" is a large, complex organization. Its major functions are performed by different divisions more or less coordinated by a set of control procedures. It ordinarily produces many products, buys and sells in many different markets. Within the firm, information is generated and processed, decisions are made, results are evaluated, and procedures are changed. The external environment of the firm consists, in part, of other firms with comparable characteristics. If the market completely determined the firm's economic behavior, these internal attributes would be little more than irrelevant artifacts. But the market is neither so pervasive nor so straightforward. The modern firm has some control over the market; it has discretion within the market; it sees the market through an organization filter.

The elaboration of these articles into a theory of the firm involved four major research commitments. They are commitments that evolved during the course of the research, but they constitute a general retrospective characterization of our research strategy:

1 *Focus on a small number of key economic decisions made by the firm.* In the first instance, these were price and output decisions; subsequently they included internal allocation and market strategy decisions.
2 *Develop process-oriented models of the firm.* That is, we viewed decisions of the firm as the result of a well-defined sequence of behaviors in that firm; we wished to study the decisions by studying the process.
3 *Link models of the firm as closely as possible to empirical observations* of both the decision output and the process structure of actual business organizations. The models were to be both explicitly based on observations of firms and subject to empirical test against the actual behavior of identifiable firms.
4 *Develop a theory with generality beyond the specific firms studied.* We wanted a set of summary concepts and relations that could be used to understand the behavior of a variety of organizations in a variety of decision situations.

Each of these commitments was critical to the research; each in some way characterizes the theory that resulted.

The focus on a specific set of economic decisions (i.e., price and output) was intended to constrain the tendency of theories of decision making to become excessively general. Quite simply, we wanted models that could predict actual decisions (if provided with necessary data), not simply models that could predict some qualitative properties of those decisions. Obviously, we wanted both kinds of predictions if we could manage them, but by restricting our focus we hoped to strengthen the specificity of the models.

The emphasis on studying actual decision processes implies a description of the firm's decision in terms of a specific series of steps used to reach that decision. The process is specified by drawing a flow diagram and executing a computer program that simulates the process in some detail. We wanted to study the actual making of decisions and reproduce the behavior as fully as possible within the confines of theoretical manageability.

The insistence on empirical content follows naturally from the emphasis on identifying the actual process of decision. It is hard to imagine constructing a process model without detailed observation of the ways in which business organizations make decisions. Thus, the empirical commitment has forced us to reconsider the traditional truculence of the firm with respect to outside investigation. We were constrained to secure research access to a number of firms under conditions that protected the competitive position of the firm without interfering with the disclosure needs of a research study.

Finally, the commitment to theoretical generality was intended to complement the insistence on specificity in models with a similar insistence on generality of concepts and broad structure. We did not want the theory to be limited to descriptive models of specific firms making specific decisions. We required a set of explanatory concepts that would serve as a framework for analysis and further research.

The results of our efforts to develop an empirically relevant, process-oriented, general theory of economic decision making by a business firm are summarized in this book. We hope they suggest both the utility and some of the problems of theoretical research on decision making in the firm. More generally, we hope they support the case for the legitimacy and importance of the business firm as a unit for detailed empirical study and theoretical analysis. More specifically, we hope that the rudiments of a behavioral theory of the firm presented in the following chapters will prove relevant both to economic theory and to the theory of complex organizations.