MANAGERIAL ACTION IN AN ORGANIZATIONAL CONTEXT: THE NEED FOR MULTI-CRITERIA DECISION-MAKING IN AN ORGANIZATIONAL CONTEXT

Josep M. Rosanas
Profesor Ordinario
Departamento de Contabilidad y Control
IESE, Universidad de Navarra
Avda Pearson, 22
08034 - Barcelona - Spain
Telephone: (34) 932534200
Fax: (34) 932534343
Email: jrosanas@iese.edu

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In the last few years (or perhaps decades), there has been an overemphasis in management in the short-run, financial variables, often at the expense of other, non-quantitative and non-financial variables that affect the long run. This overemphasis is at the origin of most of the scandals we have had, mainly through incentive systems based on these quantitative variables, disregarding the others of a more qualitative nature except perhaps through crude measurements of such variables. Quarterly earnings have been only too often the main guide by the investors in the Stock Exchange to company valuation; and management accounting techniques like balanced scorecards have cooperated in the direction of obtaining tangible, measurable results in the short run. In essence, this has to do with the fact that economic theory has invaded the management camp and imposed its values and assumptions.

Two basic assumptions of economic theory are particularly important: self interest (enlightened or not), and unbounded rationality. These assumptions, when applied to the firm, result in a firm that is in fact not too different from the idealized market of economic theory: relationships between people are impersonal, guided only by their self-interest, and based on perfect knowledge of alternatives of action and their possible consequences. Firms and markets are supposed to be alternative means of coordinating human activity, and, so, they are (and should be) substantially different in their nature. The main objective of this paper is to attempt to establish the bases of an alternative way of looking at organizations that (i) departs from these assumptions, (ii) has a logically consistent, rational basis and (iii) is more operational at the same time.

Economics-based model of the firm

The conventional, economics-based model of the firm starts with the essential idea that the objective of the business firm should be the maximization of firm value. The idea behind it is general equilibrium theory, i.e., that competitive equilibria based in consumers maximizing their utility and firms maximizing their profits are Pareto-efficient and that any Pareto-efficient outcome can be produced by a competitive equilibrium. Classical economic theory, in fact, considers only a static situation, but this limitation is not too difficult to overcome through present value calculations. In its simplest form, that argument can be found in Jensen (2000). Starting from a scenario where all production runs are infinite and cash flow streams level and perpetual, he briefly shows how profit maximization is socially optimal:
“In this simple situation, a firm taking inputs out of the economy and putting its outputs of goods and services back into the economy increases aggregate welfare if the prices at which it sells the goods more than cover the costs it incurs in purchasing the inputs. Clearly the firm should expand its output as long as an additional dollar of resources taken out of the economy is valued by the consumers of the incremental product at more than one dollar. Note that the difference between these revenues and costs is profits. This is the reason (under the assumption that there are no externalities) that profit maximization leads to an efficient social outcome.” (Jensen, 2000, p. 43)

When cash flows are neither level nor perpetual, as it was mentioned above, the concept of present value in multi-period models solves the problem: firms should then maximize the present value of all these cash flows, which is the same thing as the value of the firm. On that basis, it has become widely accepted, in theory first and, then (purportedly at least) in practice that firms should attempt to maximize their value. In theory, this is a criterion that takes into account long-run considerations. All cash flows should be included, no matter how far into the future, and properly discounted. But the impact today of a decision made today in the value of the firm seldom takes into account that much. Very often, though, actual valuations of stock in the markets are more based in the quarterly earnings than it is recognized, through the opinions of investment banking officers and financial analysts. In many of the scandals of the last decade, financial analysts were overvaluing the shares until few months or even few weeks before the scandal was discovered; and in some specific cases, like ENRON, there were reasons to be suspicious well before.

Since the objective that is a social optimum is maximizing the firm’s value, then the firm can be viewed as a principal-agent problem in a multiple version. The “principals”, of course, are the stockholders, and everybody else in the firm should do whatever in necessary to maximize their wealth. All agents are assumed to be selfish in the sense that they maximize their own utility function (Gintis and Khurana, 2006). Thus, the only way to assure that their behavior is going to be the one desired by shareholders it is through an incentive system typically related with stock values or with options.

As Ghoshal (2005) has argued, this represents a pessimistic view of human beings that is without foundation. In fact, Ghoshal’s arguments go much further: that this pessimistic view can become a self-fulfilling prophecy, making human beings selfish and opportunistic where at the beginning they were not.

**Operational problems of the economic approach: bounded rationality**

Whether the basic assumptions of any given theory are adequate or inadequate depends on the purpose of that theory. Theories are by definition a simplification of the real world. They have been often compared to maps. A map can be said to be a “theory” of the terrain it is intended to represent. It is not difficult to see that a map can never be “true” in any sense. All maps are to some extent false, as there are always details of the terrain that they do not show (Christenson, 1980). Maps may or may not be useful for finding one’s way around, but in no way are they a “realistic” representation of the world. The only possible “realistic” representation would be a perfect duplicate of the original, on exactly the same scale and with the same features and details. Obviously, that would make it perfectly useless as a map. A map is useful precisely because it is a simplification of the terrain it represents (much smaller, flat rather than rugged, brightly colored unlike the original, etc.), one that we can use to see where we are and where we
are going\textsuperscript{1}. It cannot and should not reproduce the original in every last detail. It merely needs to show what is relevant for the purpose at hand. A road map needs to show the roads and the towns, but not necessarily the landforms; in contrast, the landforms will be crucial to an engineer planning a road; he will need a very different kind of map from a motorist.

The classical assumptions of microeconomic theory are in this vein very useful for the purpose of analyzing the properties of an economic system (which, nowadays, means essentially the market system); but they may not be that useful for the purpose of analyzing what happens inside the business firms, and namely, the decision-making process. From this point of view, the value maximization hypothesis is quite an assumption. Just to illustrate, consider a downsizing decision by a business firm. Seemingly, such a decision should increase profits, since it decreases an expense. But very often, the effects of downsizing on the income statement are negative in total (Pfeffer, 1999). Conceptually, an analysis of a downsizing decision only based in its immediate effects on the income statement is what in mathematics would be considering only a partial derivative to ascertain the change of the dependent variable. Instead, the total derivative should be considered; which in our case means including all the effects of the decision, including a possible reduction of revenues in the future, through negative effects in the morale of the workforce, or by decreasing the credibility of management, and so on. All these variables are by their own nature qualitative, some of them unforeseeable and therefore very subjective to estimate if at all in the short run. In due time, the feedback loop will close and the negative effects will be perfectly known. But even if this happens, there will be no immediate association between the cause, occurred many months or years ago, and the effect that has taken place today.

Something similar happens with many other kinds of decisions, such as: (a) putting a lot of pressure on the suppliers of the firm to lower the price, that on the one hand will improve the firm’s profits, but on the other might make them go bankrupt or elicit negative reactions on their part, with possible repercussions in lower quality, delivery dates, and so on; (b) treating employees in a way that is dehumanized, with the possible consequences of lower performance, or that the more competent people leave the organization; (c) environmental damage, that may create a hostile environment for the firm; and so on. In all these cases, and in many others, management may make the wrong decision because of the attraction of immediate gains, which would be later one more than offset by future losses, or because it overlooks important variables that should have been considered.

In conventional economics the problem may be considered solved by a Darwinian type of argument: in the long run, those firms that make the right decisions will continue to exist, while those that make the wrong decisions will disappear. But this is of very little help to the decision-maker. The decision-maker needs specific rules or criteria to make a decision in an operational way, and the threat of disappearing does not make things any better from a cognitive point of view. If anything, it might put some pressure on

\textsuperscript{1} This statement is not to be confused with the very well known statement by Milton Friedman (1953) that the less realistic a theory’s “assumptions” are, the better the theory, thereby espousing an instrumentalist position quite alien to the argument of this paper. What it is argued here is that a theory cannot (and need not) take all the details of reality into account and thus be ‘realistic’. Unlike Friedman, however, I argue that the closer a theory comes to including all the variables that are relevant to the type of problems it is supposed to resolve, the better it will be.
management to use unorthodox practices that harm the firm more than anything else. In fact, in many of the scandals (e.g., Bausch and Lomb, or ENRON) there was at the origin a pressure for short-term results that were supposed to enhance long-term results: quarterly earnings, or any kind of short-term, financial goals. Telling the truth to Wall Street and forgetting the possibly adverse reaction might have lowered the market value of ENRON substantially (Jensen, 2002), but not to the levels (practically zero) it went a few months later when the forgeries were discovered. Thus, profit or value maximization, even if in theory could be the “best” possible guide to decision-making, may not be a good guide in the short run.

Bounded rationality and incomplete markets are at the origin of most of these phenomena. With unbounded rationality, it would be immediate to measure costs and benefits of any kind of decision, and even in the presence of uncertainty, an unboundedly rational decision-maker could adequately weigh the costs and benefits of the decision and able to face uncertainty in a perfectly rational way, consistent with the decision-maker attitudes towards risk. Bounded rationality implies a lack of capacity to foresee all possible contingencies, lack of knowledge of one’s own preferences and even inconsistencies in those preferences. Quite obviously, the longer the time period considered, the greater the impact of bounded rationality in decision-making, because the number of unforeseeable contingencies increases substantially. Technology, for instance: if we watch today science-fiction movies produced about a half a century ago, we see how in many aspects we are clearly beyond what anyone would have imagined to be possible at that time. Thus, bounded rationality makes it close to impossible to have as an operational objective that of maximizing firm value.

Enlightened value maximization and enlightened self-interest

Two additional assumptions are crucial in the classical economics formulation of optimality of value maximization: that all transactions go through competitive markets and that a production function determines the (X-efficient) output to be obtained from the inputs. If this were the case, i.e., if (a) the firm could find in a competitive market at a well-known price the labor supply of the kind it needs, and the same were true with raw materials and intermediate products, financial inputs, and so on; and (b) production were efficient, i.e., the production function determined perfectly the output given the inputs, then, the classical argument would be unassailable. In this case, a “dollar taken out of the economy” would be perfectly well defined and the amount of product to be obtained would be perfectly known as well, so that the comparison between the value of the product and the value of the input would be easy to make. But this, in fact does not happen. Labor, for instance, and with the possible exception of unqualified workers, cannot have a competitive market by definition. In today’s economy, where the specific knowledge of the employee is crucial, and part of this knowledge is implicit, embedded and useful only in a specific firm, it is impossible to find that kind of knowledge readily available in the market (Polanyi, 1958; Nonaka, 1994; Andreu & Sieber, 2000). And to the extent that the firm has a differentiated product, the same is often true with suppliers and other ‘stakeholders’. These complexities have led Jensen (2000) to suggest that, to be optimal, value maximization has to be ‘enlightened’, i.e., not shortsighted or too biased in favor of the immediate interests of the firm. To some extent, this means taking into account to some degree the interest of other stakeholders besides shareholders, so that their reactions are not unfavorable to the firm in feedback loops that extend beyond the immediate period after the decision has been made. Unfortunately, as Senge (2000) has suggested, when you insist in firm value maximization as criterion for decision
making, “it will almost always become, by default, short-term profit maximization. (...) Given a short enough time horizon, many of (the complex) feedbacks can be ignored. This is why manipulating profits over the short term is much easier than building wealth over the long term.”

But there is another aspect in which value maximization may not be an operational criterion either. Often, when we speak of the long run, we do not refer as much to the time horizon itself as to other variables. Selznick saw that in 1956 already:

“To take advantage of opportunities is to show that one is alive, but institutions no less than persons must look to the long-run effects of present advantage. In speaking of the ‘long run’ we have in mind not time as such but how change affects personal or institutional identity. Such effects are not usually immediately apparent, and therefore we emphasize the lapse of time. But changes in character or identity may occur quite rapidly.

Leadership is irresponsible when it fails to set goals and therefore lets the institution drift. The absence of controlling aims forces decisions to be made in response to immediate pressures.” (Selznick, 1956, p. 143)

This last paragraph is particularly important. The only way for the organization to avoid the long run consequences that would make it drift are the ‘controlling aims’. Those controlling aims have to be well-established decision-making criteria that try to ensure that the organization takes care of its identity. Which of course implies a multiple criteria decision-making process. Profit, value or whatever financial variable is surely one criterion; but we need more if we are to preserve the organization’s personality, much more difficult to put into practice than a single-criteria decision-making process, but indispensable anyway. We will see how this can be done below.

But before we go into that, there is more about firm’s value. It is the feeling that many people have that, besides wealth or economic value, all people (including shareholders) should want something more, should have wider objectives, that should include the interests of other people affected by the firm itself or by its actions, employees, suppliers and customers in the first place. This is what gave birth to the so-called ‘stakeholder theory of the firm’ (Freeman, 1994). Jensen (2000) proposes ‘enlightened stakeholder theory’ as practically equivalent to ‘enlightened value maximization’: respecting all, the interests of all the stakeholders involved, but adding “the simple specification that the objective function of the firm is to maximize total long-term firm market value”. This is of course well-intentioned and may be partly true, but it is at least paradoxical. Also, it is difficult to tell because, stakeholder theory is not a clear and well-defined theory, connected with a more general theory of resource allocation like the shareholder theory. But in any case, it represents a substantial departure from the doctrine of self-interest.

**Self-interest**

In fact, the basis on which much of the economic theory on which modern analyses of the firm are built is self interest, i.e, individuals have their own utility functions that they attempt to maximize and disregard other people’s interests and welfare. Again, while this might be a good hypothesis from the point if view of analyzing the whole economic system, it is a poor one for the purpose of guiding individual behavior.
For one thing, the hypothesis is descriptively false. As Ghoshal (2005) has observed, not only there are mothers caring for their children, or people that volunteer going to impoverished countries or regions, and so on, but the limitations of the self-interest model “...become manifest even in careful experiments devised by economists to test their theories under controlled conditions in which ‘aberrations’ such as altruism or love are strictly excluded.”

It should not then be too surprising to find people who, in the world of business, are willing to sacrifice part of their own welfare for the welfare of others, thus developing what can be called transitive motives (i.e., motives that take into account the income and outcomes of others). Sen (1977) made a subtle, but important distinction about taking into account the interest of others: the one between ‘sympathy’ and ‘commitment’. ‘Sympathy’ is in fact a form of self-interest: if you see a child being tortured (to use Sen’s example) and this distresses you so much that you want to stop it, that is ‘sympathy’. If the same fact does not affect you personally, but you believe that it should not happen, and are willing to commit some of your own resources to stop it, that is ‘commitment’. Transitive motives, in the sense I use the word here, have to do mainly with commitment.

But we should be careful here about the kind of motives we talk about and how they develop. The relationship between any two people in an organization or across two organizations (e.g., boss and subordinate, two partners, buyer and seller...) is something complex and dynamic. If both people involved attempt to maximize their own welfare at the expense of the other, the results may well be suboptimal, mainly in the long run. That is why it has been proposed sometimes an ‘enlightened’ self interest, where one party would take into account the interest of the other to the extent that this maximizes the first party’s welfare in the long run.

‘Enlightened’ self-interest is an idea originally proposed by Alexis de Tocqueville as a means of obtaining (in his words) mediocre results for developing virtues that are in fact necessary to obtain good social results in general. Tocqueville saw that egoistic attitudes were self-defeating and came up with the idea of enlightened self-interest. His first best, no doubt, is developing virtue in the individuals, so that they are committed to doing the right thing, but since this is sometimes difficult to obtain, we might set for ‘enlightened self-interest’, which, as stated, will not really develop virtues, but will produce results that are not as bad as they would be if everybody were simply egoistic.

As we will see, in business firms we need commitment. Enlightened self-interest is not enough to develop a sense of mission and of solving the customer’s needs and develop a strong sense of union within the organization.

**An alternative framework for analysis of managerial action: basic assumptions**

An alternative formulation must start by departing from the familiar assumptions on which economics is based. In essence, the bases of such a framework should include the following elements: (i) bounded rationality; (ii) satisficing behavior; (iii) intrinsic and

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2 *De la Democratie en Amérique*, part II, Ch. VIII. The original expression in French was “l’intérêt bien entendu”
transitive motives; (iv) incompleteness of formal control systems; (v) competitive advantage through knowledge. They will be analyzed in turn.

**Bounded rationality**

Individuals are boundedly rational. Specifically, individuals are not certain as to what level of satisfaction they will achieve with the results of their actions. This is one aspect of bounded rationality that, although it was already stated in Simon’s original formulation of the concept ("It is a commonplace experience that an anticipated pleasure may be a very different sort of thing from a realized pleasure" - 1997, p. 95) is often overlooked nowadays. In our case, it is crucial to think of bounded rationality both in terms of consumers and of employees: firms, as we will argue, should attempt to satisfy the real needs of both groups of people in a way that leaves them satisfied afterwards, not only in what they feel they desire before the fact.

Another aspect often overlooked in terms of decision-making is the fact that the alternatives are not available out there, so that the decision-maker can pick up the one she prefers; instead, they have to be generated at a cost. At least, in terms of the decision-maker’s time; but, often, spending other kind of material resources as well. To what extent it is worth spending more time or money to find a new alternative is in fact part of the problem.

**Satisficing behavior**

Closely linked to that, individuals don’t attempt to maximize anything, but instead they look for a satisficing solution, i.e., a solution that is good enough for the purpose at hand. This is crucial when several criteria have to be satisfied at the same time: a minimum of each of them has to be achieved. Then, perhaps, one may try to get as much as possible of one of the variables; and thus, to some extent, one might say that this variable is maximized.

But in fact a the set of criteria define a different, more complex problem. Simon (1964) expressed that clearly:

“In decision-making situations of real life, a course of action, to be acceptable, must satisfy a whole set of requirements, or constraints. Sometimes one of these requirements is singled out and referred to as the goal of the action. But the choice of one of the constraints, from many, is to a large extent arbitrary. For many purposes it is more meaningful to refer to the whole set of requirements as the (complex) goal of the action. This conclusion applies both to individual and organizational decision-making.”

This analysis has important implications. There is a minimum of each variable that has to be obtained in order to have a satisfactory solution. Therefore, below that minimum level for each variable, there are no trade-offs one can think of. If one solution does not satisfy the minimum satisficing levels for all variables, the decision maker has no alternative but to keep looking for better alternatives. Success in business is more due to finding good alternatives that to choosing between the readily available alternatives.
**Qualitative, unmeasurable organizational goals: limitations of formal evaluation and control systems**

From the analysis above, it follows that (i) many of the important variables in organizations are impossible to measure with any accuracy, and (ii) there are several dimensions to the goals of any company. Under those conditions, formal evaluation and reward systems fall short of being capable of pushing people always in the right direction. (Holmstrom & Milgrom, 1991; Baker, 1992; Gibbons, 1998). In fact, the type of phenomena analyzed in Baker (1992) and Gibbons (1998) explain to a great extent the recent scandals: when there is an incentive on a performance measurement, and the variable we would like to increase (e.g., firm value) is affected by the actions taken by individuals in a different way, one may expect them to increase the performance measurement as much as they can. In the extreme, even by faking performance and cheating.

**Motives of individuals**

The motives of the individuals clearly exceed the economic variables that affect only to themselves. I already mentioned Ghoshal (2005) about the limitations of the self-interest model. Osterloh & Frey (2003) state

“Extensive research accumulated over recent decades has established the importance of a very different kind of motivation in the firm, namely intrinsic motivation. In this case, an activity is valued for its own sake and is self-sustained. The work content itself provides satisfaction or utility.

Intrinsic motivation is indispensable when external incentives cannot solve the problems of social dilemmas, either because behavior is not observable, or because the outcomes are not attributable to individuals. If there is an intrinsic motivation to work and to cooperate, contributing to the common good ceases to become a social dilemma.”

Intrinsic motivation, thus defined, is indispensable in situations where there are severe limitations in the measures of the output and results of the firm, as I suggested in the previous section. In Osterloh & Frey terminology, intrinsic motives include what they call, following Frey (1997) obligation-based or pro-social motives.

Here, I prefer to reserve the expression intrinsic motivation to the pleasure (or displeasure, if it requires effort) of doing a good job in itself; while I have already called transitive motives those motives related with other people’s welfare.

**Competitive advantage based on knowledge and distinctive competence**

The competitive advantage of a firm rests heavily upon a type of knowledge that is produced internally, is implicit and can be used only within the firm itself, being impossible to sell it as a market good (Nonaka, 1994; Andreu & Sieber, 2000). Hayek’s (1945) idea that “practically every individual has some advantage over all others because he possesses unique information of which beneficial use can be made only if the decisions depending on it are left to him or are made with his active cooperation” is today truer than ever. Therefore, in terms of what was discussed in the previous points, we need either a perfect evaluation and incentive system, or else the individual must have intrinsic and/or transitive motives to cooperate.
Organizations as communities - loyalties and identification

Union between members of the organization has always been considered something crucial for an organization to work. The individualism implicit in most economic theories seem to have forgotten this crucial fact lately. Pfeffer has complained about the idea of organizations as communities having been abandoned or overlooked. The identification or loyalties of individuals with organizational objectives that were considered to be the basis of organizational efforts by classical writers like Barnard (1938) or Simon (1957) have lost ground to the individualism implicit in today’s analyses. In Barnard’s words (1938, chapter 7)

“... to me, at least, it appears utterly contrary to the nature of man to be sufficiently induced by material or monetary considerations to contribute enough effort to a cooperative system to enable it to be productively efficient to the degree necessary for persistence over an extended period. If these things are true, then even in purely economic enterprises efficiency in the offering of non-economic inducements may be as vital as productive efficiency.”

Simon (1957, Chapter VI) expresses a complementary point of view:

“Individuals are willing to accept organization membership when their activity in the organization contributes, directly or indirectly, to their own personal goals. The contribution is direct if the goals set for the organization have direct personal value for the individual – church membership is a typical example of this. The contribution is indirect if the organization offers personal rewards – monetary or other – to the individual in return for his willingness to contribute his activity to the organization. Employment in a business concern is a typical example of this. (...) The phrase ‘personal goals’ which is used here should be understood in a broad sense. It is by no means restricted to egoistic goals, much less to economic goals. ‘World peace’ or ‘aid to the starving Chinese’ may be just as much a personal goal for a particular individual as another dollar in his pay envelope. The fact that economic incentives frequently predominate in business and governmental organizations should not obscure the importance of other types of inducements”

Both Barnard and Simon, thus, attach a great weigh to non-monetary motives and think that firms should take care of the motives of the individuals (the famous concept of ‘efficiency’ in Barnard) so that individuals can identify with the firm.

An alternative framework for analysis of managerial action: objectives

In this context, the organizational goal cannot be that of maximizing firm’s value, which as I have shown cannot be an operational goal, but that of solving some type of customer’s needs. This is what is sometimes called the mission of the firm, although that word is more often used in a way that is void of content, perhaps with beautiful words. In this section, I’ll draw freely from the work of Pérez López (1993)

Simon (1957, Ch. VI) already saw that when the organizational goals are defined this way, customers are the only group of people that are really interested directly in those organizational goals.
The employees of the organization, in order to be interested in the organizational goal defined that way, need to have transitive motives, i.e., they have to be interested in solving the customer’s problems. If not, and remembering Hayek’s argument that we need the employees’ active cooperation to make full use of the relevant information, decisions will be mediocre, and the firm will not enjoy a good competitive position if other firms really attend the customers’ needs. To develop this competitive advantage then, a firm needs to develop the transitive motives in its employees.

How can this be done? Essentially, by having them identify with the organizational goal and be a united team where each member complements each other. The unity of the organization, then, becomes crucial to the long-run survival and competitive advantage of the firm, and should be one of the criteria for managerial decision-making.

To develop a competitive advantage, a firm needs to have a ‘distinctive competence’ that gives it character and identity. Distinctive competence is at the antipodes of opportunism, i.e., of taking advantage of specific situations to make an immediate gain:

“In studying character we are interested in the distinctive competence or inadequacy that an organization has acquired. In doing so, we look beyond the formal aspects to examine the commitments that have been accepted in the course of adaptation to internal and external pressures. (...)

(...) we come back to the problem of maintaining institutional integrity. The ultimate cost of opportunistic adaptation goes beyond capitulation on specific issues. A more serious result is that outside elements may enter the organization and dominate parts of it. When this happens the organization is no longer truly independent, no longer making specific compromises as necessity dictates while retaining its unity and distinctive identity. Rather, it has given over a piece of itself to alien forces, making it possible for them to exercise broader influence on policy. The transformation of compromise or even defeat into partial organizational surrender can sometimes be a conscious measure of last resort, but it also occurs without full awareness on the part of the participants. In our study of the Tennessee Valley Authority, referred to above, just such a phenomenon was observed. A political compromise with local and national agricultural interests was implemented by permitting part of the TVA as an organization to be controlled by those forces, with extensive and unanticipated effects on the role and character of the agency. The avoidance of opportunism is not the avoidance of all compromise; it is the avoidance of compromise that undermines institutional integrity. Opportunism also displays itself in a narrow self-centeredness, in an effort to exploit other groups for immediate, short-run advantages. If a firm offers a product or service to other firms, expectations of dependability are created, especially in the matter of continuing supply. If supplies are abruptly discontinued, activities that depended upon them will suffer. Hence a firm's reputation for dependability and concern for others becomes a matter of great importance wherever continuing relationships are envisioned. To act as if only a set of impersonal transactions were involved, with no responsibility beyond the strict terms of a contract, creates anxiety in the buyer, threatens to damage his reputation for dependability, and in the end weakens both parties.” (Selznick, 1957)

A second criterion is, then, the development of distinctive competence.

Finally, firms have to survive in the short run; and to survive means necessarily that profit must be greater than zero. This is the minimum element of effectiveness that is
absolutely necessary. For a short period of time, a firm may have negative profits; but it will not last if the situation is not reversed. This is the third criterion for decision making.

Conclusion: three criteria for decision-making

How can these criteria be applied in practice? Every decision should be analyzed in terms of the three criteria. Management has to find alternatives of action in any decision (accepting or not a given order, hiring and firing, production scheduling, preparing marketing actions, and so on) that satisfy the three criteria. Satisficing behavior is thus crucial to understanding the decision-making process implied by our analysis. When analyzing any alternative of action, management should consider:

a) what is the impact of that alternative in short-run profit

b) what is the impact of that alternative on the firm’s distinctive competence, and

c) what is the impact of the alternative on the firm’s unity, i.e., on the identification of employees with organizational goals

The first criterion can be applied in many cases (acceptance of a given order, dropping or adding products, and so on) through numerical analysis. The other two are by their own nature qualitative. But this does not mean that they cannot be evaluated. Even if it is with some elements of subjectivity. But keeping all the three criteria in mind is crucial to the long-run success of the organization. Which, of course, might mean long-run firm’s value...
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