

# BEHAVIORAL STRATEGY IN PERSPECTIVE

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ADVANCES IN STRATEGIC MANAGEMENT VOLUME 39

# BEHAVIORAL STRATEGY IN PERSPECTIVE

EDITED BY

**MIE AUGIER**

*Naval Postgraduate School, USA*

**CHRISTINA FANG**

*Leonard N. Stern School of Business,  
New York University, USA*

**VIOLINA P. RINDOVA**

*Marshall School of Business,  
University of Southern California, USA*



United Kingdom – North America – Japan  
India – Malaysia – China

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## LIST OF CONTRIBUTORS

<i>Mie Augier</i>	Naval Postgraduate School, USA
<i>Richard A. Bettis</i>	University of North Carolina Chapel Hill - Kenan-Flagler Business School, USA
<i>Philip Bromiley</i>	University of California, Irvine, USA
<i>Craig Crossland</i>	University of Notre Dame, USA
<i>Nicholas Dew</i>	Naval Postgraduate School, USA
<i>Christina Fang</i>	New York University, USA and CKGSB, China
<i>Elad Green</i>	Google, Switzerland
<i>Henrich R. Greve</i>	INSEAD, Singapore
<i>Donald C. Hambrick</i>	Pennsylvania State University - Smeal College of Business, USA
<i>Songcui Hu</i>	University of Arizona, USA
<i>Sheen S. Levine</i>	University of Texas at Dallas, USA
<i>Daniel A. Levinthal</i>	Wharton School, University of Pennsylvania, USA
<i>Chengwei Liu</i>	University of Warwick, UK
<i>James G. March</i>	Stanford University, USA
<i>Luis L. Martins</i>	University of Texas at Austin, USA
<i>Thomas C. Powell</i>	Saïd Business School, University of Oxford, UK
<i>Phanish Puranam</i>	INSEAD, Singapore
<i>Devaki Rau</i>	Northern Illinois University, USA
<i>Charlotte Reypens</i>	University of Warwick & University of Texas Dallas, USA
<i>Violina P. Rindova</i>	Marshall School of Business, University of Southern California, USA
<i>Zur Shapira</i>	New York University, USA

<i>William Starbuck</i>	Lindquist College at University of Oregon and NYU, USA
<i>Haridimos Tsoukas</i>	University of Cyprus and University of Warwick, Cyprus
<i>James D. Westphal</i>	Stephen M. Ross School of Business, University of Michigan, USA
<i>Sidney G. Winter</i>	Wharton School, University of Pennsylvania, USA
<i>Edward J. Zajac</i>	Northwestern University - Kellogg School of Management, USA

# INTRODUCTION – BEHAVIORAL STRATEGY: A QUICK ACCOUNT

Mie Augier, Christina Fang, and Violina P. Rindova\*

The origins of strategy are inherently behavioral. Some point to the publication of Simon’s *Administrative Behavior* in 1947 as such an origin point. Others point to the works of Andrews and his colleagues that defined business policy, and later strategy, as “the study of the functions and responsibilities of general management and the problems which affect the character and success of the total enterprise” from the viewpoint “of the chief executive or general manager, whose primary responsibility is the enterprise as a whole” (Learned, Christensen, Andrews, & Guth, 1965, p. 3).

The origins of strategy have also been undeniably organizational: Simon’s *Administrative Behavior* (1947), March and Simon’s *Organizations* (1958), and Cyert and March’s *A Behavioral Theory of the Firm* (1963) focused attention on the study of organizational policies, decisions, and structures as the contexts that shape how decisions are made. In one account of the field’s history, the behavioral roots of strategic management were set aside in favor of adopting economic theories to legitimate the fledgling field, provide its baseline equilibrium assumptions, and guide the adoption of sophisticated econometrics methods (Rumelt, Schendel, & Teece, 1991). Michael Porter’s reorientation of the industrial-organization economics research toward understanding the factors that limit competition, along with the research on related diversification in the 1980s, provided the theoretical foundation of business-level and corporate strategy.

Despite this shift toward economics, the behavioral roots of strategy remained strong, and researchers working from a behavioral perspective embraced “strategy process” approach. The strategy field evolved as a multiparadigmatic field,

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\*Authorship is alphabetical.

divided between strategy content and strategy process research. In the last 10 years, as we recount below, the term “behavioral strategy” has come to the forefront of strategic management (Bromiley & Rau, 2014; Gavetti, 2012; Levinthal, 2011; Powell, Lovallo, & Fox, 2011). On the one hand, the term congealed relatively recently, following the footsteps of sister disciplines which have already embraced behavioral approaches (such as behavioral economics, behavioral finance, and behavioral accounting). On the other hand, the assumptions, theoretical ideas, and empirical work that pertain to the domain of behavioral strategy have been developing since the emergence of the field of strategy itself.

The goal of the volume is to bring together scholars from several generations who have led and defined the behavioral approaches in strategy to reflect on the past, present, and future of behavioral strategy. Thus, rather than seeking empirical contributions that would fill in research gaps and expand research in specific domains, we endeavored to: (a) represent the diversity of perspectives that inform behavioral research in strategic management; (b) open up a space for reflection and provocation by scholars who are widely recognized as thought leaders both in their respective strands of behavioral strategy research and in the field as a whole; and (c) offer a set of perspectives and directions for the field of behavioral strategy at a pivotal moment in its evolution. We received enthusiastic responses from many eminent scholars represented in this volume, as they shared our premise that this is an opportune moment for a collective reflection on the theoretical foundations, key problems, varying approaches, and significance of behavioral strategy, and that such a reflection could provide some signposts for the diverse scholarly community it now encompasses.

To provide some background on the evolution of the field, we first offer a synoptic overview of what we see as behavioral approaches to strategic management research and how they inform the emerging field of behavioral strategy. We then briefly recount the formative events that led to the delineation of behavioral strategy as an identity domain and review extant definitions of the field, adding the “big tent” view, which motivated the design of this volume. We conclude by briefly summarizing the contributions to the volume.

## THE DIVIDE IN STRATEGIC MANAGEMENT RESEARCH

As Levinthal (2011, p. 1517) succinctly pointed out, “the fundamental divide” in strategy research arises from the underlying assumptions of scholars whether “choice processes are ‘rational’ and adhere to the axioms of expected utility theory, or whether choice processes are characterized by some ‘behavioral’ mechanisms.” The shift from behavioral to economic approaches received a significant boost from Michael Porter’s seminal paper titled “How Competitive Forces Shape Strategy” (1979), and his follow-on book on *Competitive Strategy* (1980).<sup>1</sup> Moving away from the core concerns with monopoly power in industrial economics, Porter’s work paved the way to understanding how the conditions that interfere with free competition enable the generation of abnormal returns. The resulting Five Forces framework has been one of the most influential ideas in strategy, and a core framework for both teaching and research,

focusing strategic management research efforts on the structural characteristics of industries.

In the mid-1980s, the Resource Based View of the firm (the RBV) directed attention to the firms' internal resources and capabilities. Barney (1986, 1995) argued that firms need to shift attention from an external industry analysis, which rests on public information to an internal analysis of resources which are valuable, rare, inimitable, and nonsubstitutable. It is important to note that the RBV traced its roots to Penrose (1959), who argued that "a firm is [...] a collection of productive resources the disposal of which between different uses and over time is determined by administrative decision" (p. 24). She also emphasized the heterogeneity of these resource collections and their role in generating superior economic performance. Penrose, however, further linked the superior performance effects of resources – which she defined as physical things and people – to the cognitive capacities of firm strategists. It is through their depth of experience and resulting insights that strategists conceived of new productive services from the resources to pursue growth opportunities. Yet, most of the subsequent theory and research in the RBV tradition generally adopted general equilibrium assumptions emphasizing the economic rationales behind the rent-generating role of resources (e.g., Peteraf, 1993). As a result, the behavioral component in Penrose's argument was lost and RBV was brought into the fold of the "optimizing hyper-rationality" that characterizes the economic perspectives in strategic management (Bromiley & Rau, 2014: p. 6).

In addition to the development of RBV as an internal perspective on competitive advantage, the strategy field witnessed several prominent intellectual responses to the pre-dominance of economic theory in strategy: the strategic leadership "upper echelons" perspective (Hambrick & Mason, 1984); the Neo-Carnegie perspective (Gavetti, Levinthal, & Ocasio, 2007; Nelson & Winter, 1982); and the cognitive perspective (Porac & Thomas, 1990; Porac, Thomas, & Baden-Fuller, 1989; Reger & Huff, 1993). While their theoretical positions, empirical approaches, and research agendas are distinct and separate, each represented a different behavioral reaction to the growing centrality of the economic paradigm and provided the theoretical and empirical foundation of much of the current work in behavioral strategy, beyond early classics noted at the outset.

The strategic leadership perspective defined a major area of inquiry within strategic management research (Finkelstein & Hamrick, 1996) by focusing on the demographic and human capital characteristics of CEOs and general managers, and the structure, composition, and dynamics of top management teams and corporate boards of directors. It offered a behavioral perspective that explained strategic choices and firm performance as driven by the individual characteristics and group properties. While this approach did not focus on psychological processes in its early stages of development, it pointed to the importance of individual and group characteristics in shaping the underlying information processing dynamics in strategic decision-making.

The Neo-Carnegie tradition provided another important influence on the behavioral foundations of strategy (Gavetti et al., 2007). Nelson and Winter (1982) evolutionary economics challenged the economic orthodoxy by articulating

that actors may not consider all latent set of alternatives and instead rely upon routines and the status quo. Relatedly, James March and his colleagues have built on earlier classics such as Cyert and March (1963) and argued that actors do not update priors and learn optimally. Rather, they learn from experience in response to performance feedback. Such learning leads to various behavioral “pathologies” such as the myopia of learning, superstitious learning, and competency traps. In addition, Levinthal (1997), and subsequent work utilizing the NK paradigm, further showed how learning is complicated in interdependent contexts. Thus, the Neo-Carnegie approaches articulated a behavioral perspective of strategy as being driven by habits and routines and learning from feedback that is ambiguous, delayed, or otherwise misleading. March (2006) made further break from traditional conceptions of rationality, arguing that the field of strategic management can gain from exploring foolishness and adaptive intelligence.

A third behavioral response was evident in the cognitive perspective in strategy research that emerged in the late 1980s and early 1990s. This perspective built on the growing interest in interpretive processes in organizations to investigate their strategic relevance for strategic management questions, such as threat-opportunity framing (Jackson & Dutton, 1988), cognitive industry boundaries (Fombrun & Zajac, 1987; Huff, 1982), competitive groups (Porac & Thomas, 1990), dominant logic of the corporation (Prahalad & Bettis, 1986), and industry knowledge recipes (Spender 1989). This work shifted the focus from the characteristics of the environment to the *interpretation* of the environment by strategists, as a function of their cognitive structures and processes. Porac et al. (1989) influential paper on the Scottish knitwear industry showed that managers not only interpret environments, but also construct them by enacting their mental models into distinct patterns of interactions and exchange. The cognitive perspective, therefore, acknowledged that environmental complexity leads to partial representations and potentially bounded rational decisions. However, it took a step further highlighting the creative constructive power of managerial perceptions, knowledge, and beliefs, presenting the environments themselves as constructed through perceptions, actions, and communications (Rindova & Fombrun, 1999).

## ORGANIZING MOVES

The three different strands of behavioral approaches to strategy briefly summarized earlier operated as distinct paradigms throughout the 1990s and early 2000s. In 2007, Jerker Denrell and Christina Fang organized a symposium at the Annual Meeting of the Academy of Management titled “Behavioral Strategy: A Research Agenda” with the goal of bringing together researchers dealing with strategy, behavioral finance, and behavioral decision theory to examine core strategic issues around strategic factor market efficiency. In 2010, Daniel Lovallo (one of the panelists in the 2007 symposium) and Oliver Sibony published an article in the *McKinsey Quarterly* titled “The Case for Behavioral Strategy” calling for strategists to take into account known heuristics and biases in decision-making and to proactively seek to debias important decisions. The paper quickly became one of the most downloaded papers from the *McKinsey*

*Quarterly* that year. Later that year, Sheen Levine and Shayne Gary organized a professional development workshop at the Academy of Management Annual Meetings with the explicit goal to rethink the neoclassical economic paradigm as a foundation for strategic management research and to advance behavioral and cognitive research as an alternative theoretical foundation for strategy.<sup>2</sup>

Around this time, efforts to formalize behavioral strategy as a distinct field accelerated. Thomas Powell, Daniel Lovallo, and Craig Fox guest-edited a special issue at *Strategic Management Journal* (SMJ) titled “Psychological Foundations of Strategic Management” that called for papers examining the psychological foundations of strategy. Thomas Powell and Richard Bettis, among others, also spearheaded initiatives that led to the development of Behavioral Strategy Interest Group within the Strategic Management Society.

Through these activities and publications, behavioral strategy came to be defined as merging “cognitive and social psychology with strategic management and practice” with the goal to “strengthen the empirical integrity and practical usefulness of strategy theory by grounding strategic management in realistic assumptions about human cognition, emotion, and social interaction” (Powell et al., 2011, p. 1371). The psychological foundations of behavioral strategy are now widely recognized. For example, Gavetti (2012, p. 267) argues that behavioral refers to psychological underpinnings of a given phenomenon; and Bromiley and Rau (2014) further identify behavioral strategy with the assumption of bounded rationality. This approach has a number of advantages. First, its clear and distinct theoretical foundation complements the predominant economic approaches. Second, this approach also shares similar conceptual and methodological apparatus with behavioral economics, thereby creating opportunities for cross-fertilization among related sister disciplines.

While we agree that human psychology should be at the center of behavioral research in strategy, we see the need for two fundamental augmentations of the approach and definitions of behavioral strategy. First, we see a need for a broader understanding of the human element in strategy and markets. As Powell (2017, p. 67) has recently argued, “Behavioral research shows that human market participants do not behave like rational economic agents. Real people are in many ways more impressive than economic agents. They are capable of passion, benevolence, insight, and perseverance. They have moral and esthetic ideals, and they exhibit altruism, trust, reciprocity, compassion, justice, loyalty, and love.” We therefore advocate for an inclusive approach to studying the people who make, evaluate, or contribute to firm strategies. Such an inclusive approach incorporates the study of values, emotions, social and cultural embeddedness, identity, esthetic knowledge and perception, and the lived experience. In terms of disciplinary knowledge, it would welcome disciplinary transfusions not only from cognitive and social psychology, but also from sociology, political science, anthropology, philosophy, linguistics, communications, and cultural and art studies.

Second, while bringing the focus back on the strategists – as individuals and groups – is valuable, firms and even markets are not simply collection of individuals. Indeed, the long-standing behavioral roots of strategy are organizational. Further, the changing nature of organizations, and the ways in which they

incorporate customers and other actors in their core productive activities, suggests that there is an opportunity for behavioral strategy to broaden its disciplinary foundations to account for collective-level behavioral processes, such as those studied in sociology. The collective contributions to this volume, discussed next, point in similar directions. While reaffirming the psychological foundations of behavioral strategy, they also open up new conversations about the human experience and the role of organizations.

## THE CONTRIBUTIONS IN THIS VOLUME

The contributions represent reflections on and theoretical extensions of behavioral research in strategic management and are organized in three sections and an epilogue. Each section addresses the goals for this volume in different ways. The first set of papers discusses the emergence and evolution of the field of behavioral strategy. The papers in the second set offer a variety of perspectives on behavioral strategizing, both extending core approaches and charting directions for new ones. The papers in the final set spell out important implications for empirical research, normative recommendations, the study of firm performance, and teaching strategy. The epilogue offers one personal narrative of navigating the emergence of the field.

The first section opens up with Jim March's contribution titled "Some Thoughts on the Development of Disciplines, with Particular Attention to Behavioral Strategy." He reflects on the evolution of fields in general, taking a close look at the evolution of the "sister discipline" of organization studies. The development of the field, like much of its content, is the result not of optimal, well-calculated rational-choice decisions. Instead, it involves a diverse set of ideas, intellectual traditions, and developments. The field of behavioral strategy is in a precarious position of emergence, which is both an opportunity and a challenge. Part of the opportunity, March suggests, is to expand beyond its traditional emphasis on decision-making and bounded rationality. In the next paper, titled "A Strategy for Behavioral Strategy: Appraisal of Small, Midsize and Large Tent Conceptions of this Embryonic Community," Don Hambrick and Craig Crossland highlight the ambiguity of the term of behavioral strategy and its subfield, describing three alternative conceptions of behavioral strategy, each having pros and cons, and each pointing to different paths for the future of the field. A "small tent" conceptualization essentially applies the logic of behavioral economics to strategy; a "midsize tent" conceptualization includes the application of cognitive and social psychology to strategic management phenomena; and a "large tent" conceptualization broadens up the behavioral foundations for strategy even further. The authors offer rich discussion of vibrant streams of research within the midsize and large tent definitions and offer their expectations of how these alternative scenarios of field may unfold.

In the third paper in this section, Jim Westphal makes a strong case for the large tent view in his contribution titled "Decoupling and Intergroup Dynamics in Behavioral Strategy, and a More Integrative Alternative." He builds on social categorization theory and personal interviews with colleagues with different types of behavioral self-identifications to warn the emerging field about the

dangers of ingroup/outgroup dynamics that marginalize perspectives that ought to be included. He proposes an approach that takes interdisciplinarity to heart and encourages collaboration across subfields in order to increase both the contributions and the position of behavioral strategy to the field, as well as creativity and the rate of theoretical advancement in the field as a whole. The paper by Mie Augier and Nick Dew concludes this section by reviewing larger history of the field of strategic management “with Simon in mind” and offering several guiding principled inspired by Simon’s work, on which the field of behavioral strategy can build.

The second section, “Perspectives on Behavioral Strategy and Strategizing” includes nine contributions, each taking a different perspective on strategy making and the core processes of strategizing. In the first contribution titled “From Strategy to Strategic Organization,” Dan Levinthal reminds us that strategy problems are fundamentally “complex” and “hard” and surveys different approaches for dealing with this strategic recalcitrance. He advocates a pragmatic approach to strategy that focused on the actions and interactions of boundedly rational individuals to improve the survival of the organization. Such an approach invites taking strategic organizational design seriously and in an evolutionary and behavioral way. Phanish Puranam’s contribution titled “The Organizational Foundations of Behavioral Strategy” picks up on the topic of organizations as contexts for strategic behavior and articulates both its core components: goals, representations, and choices, and the organizational designs that operate on them. The paper makes a compelling case for behavioral strategy as understanding individuals in context as complex systems nested within larger complex systems.

The next three papers focus on two core strategizing processes – search and sensing. Henrich Greve poses the question “Where to Search” and extends the theory of problemistic search by observing that current approaches fail to explain “how a firm goes from a falling short on a broad goal to taking a specific action in response.” He considers a multiplicity of alternatives about how organizations respond to broad goals, identifying goal multiplicity, power, cognition, and the environment, all as having the capacity to direct search.

Sid Winter’s essay on “Organizational Sensing and the Occasions of Strategizing” presents a provocative perspective on importance of deliberative thinking and the limits to its understanding, especially under conditions of information asymmetries – “us” versus “them” strategizing. Under such conditions, the keen attention to constraints – and the development of a variety of sensors—are paramount to strategizing. Sensing then is a complex system that bestows organizations differential recognition of problems and opportunities. Sensing is also the concept explored in Green and Shapira’s paper, “Hierarchical Sensing and Strategic Decision Making”. They simulate an organization as a complex signal detection system, comprising individuals who perceive, interpret, and act upon information they receive. They investigate the interaction between organizational hierarchical structure and individuals’ attentional and cognitive constraints on the organization’s capacity to identify changes in its environment. The paper by Rich Bettis and Songcui Hu, “Bounded Rationality, Heuristics, Computational Complexity and Artificial Intelligence,” in turn, draws on Newell

and Simon's work to argue that computational complexity provides a rigorous, important, and largely ignored theoretical grounding for the study of bounded rationality. The optimal solutions of many important problems in economics, behavioral strategy, and other fields are simply intractable and cannot be generally be computed by any known or envisioned computer. As such, strategy is by necessity behavioral, and heuristics rather than optimization should be the basis for managerial and organizational decision-making.

The three final papers in this section offer perspective that depart from the current definitions and approaches in behavioral strategy. Thomas Powell, in his paper titled "Romantics, Mercenaries, and Behavioral Rationality" advances the notion of behavioral rationality, which – in contrast to normative economic rationality – "draws on human beliefs, passions and moral values to produce commitment-maximizing courses of action." The notion of behavioral rationality implies two distinct dimensions for behavioral strategy: decisions – which have received the bulk of prior research attention – and actions – which depend on different psychological processes and states that have been largely ignored. The success for the field of behavioral strategy, he further argues, is less likely to result from removing cognitive biases (debiasing) than from helping firms understand how to generate strategic actions. Violina Rindova and Luis Martins' contribution titled, "The Three Minds of the Strategist: Toward an Agentic Perspective on Behavioral Strategy" similarly challenges the focus of behavioral research on decisions alone. They build on the sociological work on agency to distinguish between agentic and decision-making/information processing capacities. Because agency unfolds across the temporal horizons of the past, present, and future, an agentic perspective accounts for the different sociocognitive processes that anchor strategists in the past, enabling them to manage the present and support their envisioning of the future. Strategists' agentic capacities, in turn, depend on how they combine these temporally oriented cognitive processes. Finally, Haradimos Tsoukas, in his paper titled "Praxis, Character and Competence: From a Behavioral to a Communitarian View of the Firm" introduces a communitarian view of the firm that departs from behavioral strategy's limiting assumptions—namely, the assumptions of methodological individualism and dualism. The communitarian view accounts for praxis, and its formative effects on agents, as well as for teleological action, and its implications for the value commitments that firms make. These ideas implicate Selznick's notions of distinctive competences and organizational character, pointing behavioral strategy toward recovering some of its normative orientation roots.

The final section, "Behavioral Strategy in Action," contains four papers that address the implications of behavioral strategy for core domains of action, including theoretical prescription, firm performance, empirical research, and teaching. In particular, the paper by Phil Bromiley and Devaki Rau, "Behavioral Strategy and Strategy Prescription" discusses and contributes to the underdeveloped area of "strategy prescription." While the idea of a united prescriptive theory is "attractive but illusory," they find behavioral strategy insights can fruitfully be applied to strategy prescription. They stipulate the foundations of such prescriptions: bounded rationality (and satisficing) and decomposed

problem-solving, consistent with mid-range theories of organizations. Mid-range theories of strategy, they suggest, emphasize near decomposability and hierarchical organizations of human systems, and can be useful for understanding organizations and processes and structures for developing ways to frame problems and for offering strategies. Christina Fang and Chengwei Liu concretize the idea of prescriptive behavioral strategy in their contribution titled “Behavioral Strategy: An Alternative Account of Superior Profitability,” which proposes a normative theory of superior profitability. Building on decades of research on sociocognitive biases, they argue that strategists can exploit these generative mechanisms of behavioral biases to outsmart and outcompete rivals in a systematic way.

Charlotte Reypens and Sheen Levine turn their attention to the empirical tools that can advance research in behavioral strategy. Their contribution titled “Behavior in Behavioral Strategy: Capturing, Measuring, Analyzing” presents a toolbox of methods to capture observed outcomes and expose underlying processes: experimental tasks to simulate environments and capture behavior protocol analysis and text analysis to understand cognitive processes, applying them to collect data on two key topics: the exploration–exploitation trade-off and strategic risk taking. Finally, Bill Starbuck, in his paper titled “Teaching Strategists to Take Advantage of What Happens” challenges our approach to teaching strategy and raises the possibility for improving teaching effectiveness in the domain of strategy by teaching students to recognize and effectively respond to unexpected events. He discusses four helpful procedures that tend to improve firms’ responses to strategic events: (1) future-perfect framing, (2) scanning for relevant events, (3) experimenting with strategic variations, and (4) watching experimental results carefully and events opportunistically.

As a closing contribution to the volume, Ed Zajac offers a personal narrative to discuss the mindset inclined to connect intellectual worlds, such as behavioral and economic views on strategy, that had been seen as divided [...] well, it wouldn’t be fair if we told his story, would it?

## NOTES

1. The book was voted the ninth most influential management book of the twentieth century in a poll of the Fellows of the Academy of Management.

2. This yearly workshop has attracted on average 200 attendees and has involved speakers ranging from evolutionary biology to computer science.

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