

BEHAVIOURAL THEORY
OF THE FIRM

Behavioural Theory of the Firm

developed comprehensively by
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The model has the following sequence:

2. The firm as a coalition of groups with conflicting goals and interests.
3. The process of formation of goals of the various groups within the firm.
4. Defining goals of the firm by top management: satisficing behaviour of the firm.
5. Resolution of the conflicting demands and interests of the various groups of the firm – coalition.
6. The process of decision-making.
7. Uncertainty and the environment of the firm.
8. Comparison of the behavioural theory with the Traditional theory of the firm.

1. The firm as a coalition of groups.

The behavioural theory of the firm, relates to a multiproduct corporate firm operating under uncertainty in an imperfect market.

The shareholders (owners) do not have much say in the management i.e., Ownership is separated from management.

The Theory recognises the complex nature of the firm which is seen as a coalition of groups with conflicting goals and interests.

The theory considers Managers, shareholders and workers as the most important groups who exercise considerable weight at the decision level.

These groups have their set of goals and demands.

Managers want high salaries, power and prestige.

The shareholders want high dividends, growing capital and large market size.

Workers want high wages, good service conditions and social security measures.

2. The Process of Goal formation

- The top management of the firm sets the goals of the firm which often are in conflict with the demands of the various groups in the firm. The management thus performs the following important functions:
 - 1. Reconciling the conflict between the goals of the firm and those of individual groups.
 - 2. Resolving the conflict between the demands of the various groups.
 - 3. Taking decisions for implementing the set goals of the firm.

3. Defining Goals of the firm:

The top management in a modern corporate firm enjoys the ultimate authority to set the goals of the firm.

Production goal : is set by Production department. CEO wants the production process to be smoother, without fluctuations so that the plant is neither overworked nor idle.

Inventory goal: is set by Inventory department or jointly by Production and Sales Depts. The production department wants adequate stocks of raw materials for uninterrupted production while sales department expects an adequate stock of goods produced for meeting the market demand.

The Sales goal: The sales department determines both the sales goal and the market share goal and decides the strategy to achieve them.

The Profit goal: This is set by the Top management, keeping in view the expectations of the shareholders, bankers and other financial institutions. Since profits generate resources for further expansion, the top management sets a profit target consistent with the growth of the firm.

Satisficing behaviour of the firm:

The goals set are flexible and revisable from time to time depending on past attainments, conditions prevailing in the economy and changes in their aspirations of the various groups within the firm.

The actions of the firm are guided by limited or bounded rationality. The firm's management after considering all possible alternatives decides the order of preferences for different goals. The management in a modern corporate firm has limited information, limited time and limited computing ability. Therefore, the management examines a few alternatives and chooses the best out of them. This is the *satisficing behaviour* of the firm which is rational.