

Decision-making in Firms

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Abstract

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Corporate governance usually refers to the relations between various stakeholders of a firm; management, employees and shareholders. This approach of corporate governance involves an analysis of the distribution of decision power within corporations that is based on the alleged conflicts of interests between these groups. This approach neglects the allocation of decision power between various layers of management in corporations, which is of utmost importance for strategic decision-making. The field of innovation management studies processes of communication and strategic decision-making within firms. Standard decision making tools like discounted cash flow have underestimated the margins of error that are inherent to decision making under uncertainty. Firms that want to be successful at innovation, therefore, have developed new approaches to strategic decision-making. The paper puts these new approaches into perspective. Induced and autonomous strategic processes and the learning organization are concepts that have come up to deal with the challenges innovative firms face. Open source has entailed new organizational forms. These new approaches to strategic decision making should be coupled to finance and incentive theory to achieve a more complete picture of the governance of innovative firms.

Corporate strategy involves investments in projects based on a plan for the firm's future. It can also entail the divestiture of parts of the firm. Corporate strategy wants to distinguish a company from its rivals by creating a competitive advantage. Corporate strategies thus need to differ

to achieve this goal. Rivalry creates both winner and losers. Uncertainty about the outcomes of investment projects cannot be curbed by seeking identical strategies, since this would increase collective risk. Stability thus requires diversity of strategies pursued by firms in an industry. Diversity is also sought by innovative firms that want to create diversity of investment projects within their organization.

Research on decision making in innovative firms has highlighted various methods applied by firms to create variety and to absorb risk. Processes that steer the generation and approval of ideas are crucial to achieve this. New ways of decision-making require organizational structures within firms that can manage human capital optimally. Firms need to combine freedom of speech with a clear allocation of decision rights and responsibilities. The paper discusses several organizational models that have emerged to achieve this goal. The multi-divisional firm seems less suited to generate and select ideas. More centralized models have emerged. Variety also emerges from the establishment of new companies. Modern web-based models have emerged that connect people without a corporate form; thereby extending the number of people that can contribute hugely. These new forms of organization seem decisive in present day competition for competitive advantage.

New competitive equilibrium is established in both product and financial markets through the entry and exit of firms. Internal and external selection methods are complementary. A rich array of financial institutions is important to achieve equilibrium at a higher level of aggregation than the individual firm. We can think of industries and regions.