JSGS 865.3 – Decisions in Organizations

	University of Saskatchewan Campus	
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Term:	Fall 2011	Fall 2011
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Date and Time:	Tuesdays - 9:00 a.m. – 12:00 p.m.	Tuesdays - 9:00 a.m. – 12:00 p.m.

CALENDAR DESCRIPTION

Most policy schools aspire in their research and their teaching to say something about why governments do what they do (or what the pattern of governmental activity looks like) and what makes up the normative and empirical deficiencies of this activity. These tasks require an appreciation of how policy is constrained at the micro and macro levels. Constraint is, of course, relative. There are plenty of determinists whose theories now sit on the junk pile of historicism. At the same time, governments cannot simply do whatever they want. The capacity to generate goals is itself constrained, and governments are constrained at the macro level by culture, resources, historical paths, class antagonisms, gender biases and institutions.

Policy actors, however, are not simply victims of forces and pressures beyond their control. To adequately model the policy process, room needs to be made for innovation and agency and that room needs to be properly theorized. This process, however, is characterized most emphatically by uncertainty. For all of the rules and regulations, the demands and constraints, and the "governing ideas" that set the standards of success, there is still room to innovate and to screw things up. In short, there is a micro policy world in which administrators and political actors must operate and it is not the sum total of macro constraints. Arguably, policy programs have neglected the individual actor and inadequately connected aspirations and limitations at the individual level to the capacity of governments to both create and realize their objectives.

The Decision in Organizations course deals with individual decision makers situated within these macro constraints, but also the micro constraints that people face as a result of their own cognitive processes and limitations. The course starts with the decisions that people make in the policy area as being the consequence of the cognitive frames that they hold, which in turn are determined by individual (or micro) factors (some of which can be captured by prospect theory and other psychological models) and more macro factors (such as the prevailing policy environment). Cognitive frames are chosen as the starting point because doing so allows one to see how mistakes can be made; and since it highlights the key problem - how to make decisions when the future is unknown. Starting with the cognitive frames approach also provides an explanation of why organizations are created and what the purpose is that they serve.

On the individual (or micro) side, the course considers prospect theory (and framing, which has received perhaps even less attention), the behavioural elements that Bazerman discusses, and other concepts such as cognitive dissonance and identity. There are lots of examples to use to illustrate these ideas - but interestingly, many of them may have to come from the business area for the first while, since not much work has been done in the policy area. However, this lack of work means that students will be able to find policy examples and write them up as journal articles.

The course will be wrapped up with a discussion of how the macro and the micro come together. Indeed, the strength of the approach that used in this course is that both the micro and macro influences on decision-making can be nicely linked together. Also, somewhere along the way - likely at all points - it needs to be stressed that organizations are critical to understanding policy and to provide examples of this. In talking about organizations, of course, it needs to be pointed out that it is not just government organizations that are important, but all types of organizations, including universities, industry associations and NGOs. The work on policy networks could also be nicely folded in at this point.

The material in this course is built on at least five building blocks:

- The need to integrate the micro foundations of behaviour with the macro behaviour that is observed. (i.e., the need to start with the decision making processes of individuals and aggregate this behaviour to that of groups);
- The need to understand the role of uncertainty and indeterminacy (always in the context of the future)
- The role of causality and explanation (e.g., pattern creation) in allowing decisions to be made under uncertainty
- The role of heuristics and biases in dealing with (2) and (3) in the context of decision making
- The set of pathologies that can affect decision making, their consequences on organizations (and the consequences of organizations for these pathologies), and possible corrections

COURSE CONTENT AND APPROACH

<u>I. Micro Foundations of Decision Theory: Rationality and Uncertainty (Weeks 1-2)</u>

Expected Utility Theory

Expected utility theory, combined with discounting, has emerged as the basic framework used for examining decision making under conditions that involve uncertainty and the passage of time. Although this theory is being challenged by the findings of behavioural economists, it nevertheless must be understood in order to examine the various behavioural aspects that are increasingly being examined. Topics to cover include: diminishing marginal utility of wealth, expected utility, risk aversion versus risk neutrality, discounted expected utility.

Kahneman, D., and A. Tversky. 1984. "Choices, values and frames," *American Psychologist* 39: 341-50.

Elster, J. 2007. *Explaining Social Behavior: More Nuts and Bolts for the Social Sciences*. Cambridge University Press, Cambridge.

Chapter 11 Rational Choice

Bounded Rationality and the Satisficing Heuristic

Like others in the cognitive science tradition, Herbert Simon assumed that rationality was "bounded." But that did not mean, for Simon, that people are stupid. The nature of rational decision-making required, for him, an appreciation of both the cognitive limitations and the task environment. Some means of addressing limitations, most famously "satisficing" could yield very high order performance. Simon is an optimist, but how can his insights into decision-making translate into better organizational performance?

Herbert Simon. 1955. "A Behavioral Model of Rational Choice." *Quarterly Journal of Economics* 69: 99-118

Bryan Jones. 1999. "Bounded Rationality," *Annual Review of Political Science* 2: 297-331.

John Padgett. 1980. Bounded Rationality in Budgetary Research," *American Political Science Review* 74: 354-72.

<u>II. The Micro Foundations of Decision Theory: Non-rational perspectives (Weeks 3-5)</u>

System 1 and System 2

This section of the course begins with an examination of the current understanding of the way that decisions are made in the brain. This process is described in terms of a dual cognitive system – the so-called System 1 is the source of automatic and intuitive judgments, while System 2 is the source of rational reasoning. The course then looks at how decision making is theorized when it is no longer assumed that individuals make decisions in a rational way – i.e., individuals rely on System 1 rather than System 2.

Kahneman, D. 2002. "Maps of bounded rationality: A perspective on intuitive judgment and choice." *Nobel Prize Lecture* vol. 8.

Evans, J.St.B.T. 2003. "In two minds: dual-process accounts of reasoning." *Trends in Cognitive Sciences* 7 (10): 454–459.

Prospect Theory and Framing

This section of the course examines the situations where the predictions of expected utility theory fail to hold. Prospect theory and anchoring offer an alternative model to expected utility theory that captures the anomalies that exist between the predictions and actual behaviour. In addition to accounting for the differential impact that losses and gains have on people's decisions, the theory assigns weights that differ from those associated with expected utility theory. The theory also views decisions as being based on changes in wealth, rather than on the level of wealth levels. Applications of prospect theory (i.e., the differential impact of losses and gains) to policy are examined.

Kahneman, D., and A. Tversky. 1984. "Choices, values and frames." *American Psychologist* 39: 341-50.

Mercer, J. 2005. "Prospect Theory and Political Science," *Annual Review of Political Science* 8:1-21

Elster, J. 2007. *Explaining Social Behavior: More Nuts and Bolts for the Social Sciences*. Cambridge University Press, Cambridge.

Chapter 12 Rationality and Behavior

Mental Accounting

Rationality indicates that all gains and losses should be aggregated and then evaluated. Observed decision making, however, does not match the predictions of this rational model. Mental accounting – which indicates that people group benefits and costs in different accounts that are then evaluated differently – provides an explanation for observed decision making.

Thaler, R. 1985. "Mental Accounting and Consumer Choice," *Marketing Science* 4(3): 199-214

Thaler, R. 1999. "Mental accounting matters," *Journal of Behavioral Decision Making* 12(3): 183–206.

Discount Rates

Discounted expected utility theory precisely specifies how future utility is discounted. The decisions predicted by this theory generally do not hold. Instead of making choices in a manner that is consistent with a constant discount rate, individuals appear to make decisions using a discount rate that falls over time. This section of the course looks at theoretical models that have been developed to account for this observed decline in the discount rate, and examines the implications of declining discount rates for policy decisions. Areas of particular importance are pensions and addictions.

Ainslie, G. 2001. *Breakdown of Will*. Cambridge University Press.

Laibson, D. 1998. "Life-cycle consumption and hyperbolic discount functions," *European Economic Review* 42 (3-5): 861-871

III. Organizational Behaviour (Weeks 6-7)

Overview

Most decisions of importance are made in organizations (as Simon nicely lays out in his article). This section provides two quite different views of how decisions are made in organizations. One of these views – incrementalism – views organizational decision making as a boundedly rational process, while the second of these views – the garbage can theory – views organizational decision making as chaotic and random.

Herbert Simon. 2000. "Public Administration in Today's World of Organizations and Markets." *PS: Political Science and Politics* 33(4): 749-756

Incrementalism

One of the earliest, and most enduring, attempts to theorize decision-making in the context of limited cognitive capabilities is captured in the work of Charles Lindblom. Lindblom had little to say about the nature of those limitations, but much to say about their effect on the quality of public policy. His version of incrementalism has attracted critics who claim that it is insufficiently precise in its theoretical formulation (e.g., Bendor), others who seek to locate its usefulness in particular circumstances (e.g. Lustick) and still others who are inclined to defend and extend Lindblom's original insights (e.g. Weiss and Woodhouse). The readings below sample the many articles and books on the topic. Assuming Lindblom is on to something, how can his theorizing be improved to help us understand policy challenges and avoid policy errors?

Charles Lindblom. 1959. “The Science of ‘Muddling Through’.” *Public Administration Review* 19: 79-88.

______. 1979. “Still Muddling, Not Yet Through.” *Public Administration Review* 39: 517-26

Ian Lustick. 1980. “Explaining the Variable Utility of Disjointed Incrementalism: Four Propositions.” *American Political Science Review* 74: 342-353.

Michael M. Atkinson. 2011. "Lindblom's Lament: Incrementalism and the Persistent Pull of the Status Quo," *Policy and Society* 30 (1): 9-18.

Garbage Can Theory

Garbage can theory is an influential models of organizational choice. It describes a process driven world that is said to dominate in what are called “organizational anarchies,” which in turn are characterized by problematic preferences, unclear technologies and fluid participants. The original statement of this theory has had a major influence on institutionalism in political science (March and Olsen) and on conceptualizations of the policy process (Kingdon). It has also attracted critics who complain about its lack of rigor and the absence of a theory of individual choice (Bendor, et. al.)

James March and Johan Olsen. 1987 [1976]. *Ambiguity and Choice*. Bergen: Universitetsforlaget.

John W. Kingdon. 2003. *Agendas, Alternatives, and Public Policies*. 2nd ed. New York: Longman, chs. 4, 8, 10.

Jonathan Bendor, Terry M. Moe, and Kenneth W. Shotts, “Recycling the Garbage Can: An Assessment of the Research Program,” *American Political Science Review* 95: 169-190, and the rejoinder by Johan P. Olsen, “Garbage Cans, New Institutionalism, and the Study of Politics,” *American Political Science Review* 95: 191-98.

<u>IV. Problem of Organization (Weeks 8-9)</u>

Markets, Firms or Government?

Organizations are ubiquitous in modern society. This section of the course examines attempts to understand the fundamental nature of organizations. We begin with the existential question: why do we have to have organizations like business firms or government agencies? Why, with the power of markets, do we need administration?

Hayek. F.A. 1945. “The Use of Knowledge in Society.” *American Economic Review* 35(4): 519-530

Ronald Coase. 1937. “The Nature of the Firm.” *Economica* 4(16): 386-405

Timothy Besley and Maitreesh Ghatak. 2003. “Incentives, choice, and accountability in the provision of public services.” *Oxford Review of Economic Policy* 19 (2): 235–249.

Evaluative Criteria: Efficiency, Equality, Effectiveness

As we argue about whether to use markets, firms or government to provide public goods or avoid public bads, the question arises: how are we to evaluate the choices on offer? Without making the case that there are no other criteria, consider that efficiency, effectiveness, and equality are among the most compelling on offer. Efficiency is a criterion beloved of economists, equality and effectiveness speak to public objectives that often require the assembling of political power.

Arthur Okun. 1975. *Equality and Efficiency: The Big Trade- Off*. Washington: The Brookings Institution.

R.H. Coase. 1960. “The Problem of Social Cost.” *Journal of Law and Economics* 3 (October): 1–44.

Richard R. Nelson. 2011. “The Complex Economic Organization of Capitalist Economies.” *Capitalism and Society*: Vol. 6: Iss. 1, Article 2.

James Q. Wilson. 1991. *Bureaucracy* New York: Basic Books ch. 9.

Terry Moe. 2005. “Power and Political Institutions,” *Perspectives on Politics* 3 (2): 215-233.

Opportunism as the Key Organizational Challenge: Agency Theory

Agency theory forms the basis of much of the theorizing about decision making in organizations. It is premised on the idea that the inevitable tensions that exist between agents and principals require inventive organizational solutions or organizations will break down. Although this theory is being challenged it must be examined and understood to be able to understand the main stream literature on organizations and the critiques that are increasingly being launched against agency theory. Topics to cover include: information asymmetry, moral hazard, incentive schemes, power of incentives, risk aversion and risk sharing.

Oliver E. Williamson. 1981. "The Economics of Organizations: The Transaction Cost Approach." *American Journal of Sociology* 87 (3): 548-577.

Avinash Dixit. 2002. "Incentives and Organizations in the Public Sector: An Interpretative Review," *The Journal of Human Resources* 37(4): 696-727.

Jon Elster,. 2007. *Explaining Social Behavior: More Nuts and Bolts for the Social Sciences*. Cambridge University Press: Cambridge, ch. 26.

Knowledge as the Key Organizational Challenge: Cognitive Theory

An alternative explanation for the emergence of organizations is that they serve as a way of accumulating the wisdom of a group of people to make the key decision required for organized behaviour, namely, "What to do next?" While the authors in this vein recognize that opportunism can be a problem, they argue that agency problems are addressed relatively effectively through institutions and norms at the society level and through culture and identity at the organizational level. Instead, the key role of organizations is to harness the benefits of a "division of cognition" and thus make better decisions than can be done by individuals acting alone.

Brian Loasby. 2001. "Organisations as Interpretative Systems." *Revue D'Economie Industrielle* 97(4): 17-34.

Brian D. Jones. 2003. "Bounded Rationality and Political Science: Lessons from Public Administration and Public Policy." *Journal of Public Administration Research and Theory* 13 (4): 395–412.

Simon, Herbert. 1997. *Administrative Behavior: A Study of Decision-Making Processes in Administrative Organizations*, 4th ed. (orig. 1945) The Free Press, ch. 5.

V. Cognitive Limitations and Organizational Pathologies (Week 10)

Overconfidence and Predictable Surprises

Most business leaders are overconfident, and this overconfidence manifests itself in companies paying too much for acquisitions and in making unprofitable investments. The same cognitive errors that lead to overconfidence can also lead to missing what Bazerman calls "predictable surprises." What cognitive errors lead to overconfidence and predictable surprises? How can these errors be minimized? How does overconfidence affect policy decisions? Do politicians underestimate the time and cost involved in putting policies and programs in place? What are some of the repercussions of this behaviour?

Michael Watkins and Max Bazerman. 2003. "Predictable Surprises: The Disasters You Should Have Seen Coming." *Harvard Business Review* 81(3): 72-80

Dan Lovallo and Daniel Kahneman. 2003. "Delusions of Success: How Optimism Undermines Executives' Decisions." *Harvard Business Review* (2003) July: 57-63

J. Edward Russo and Paul Schoemaker. 1992. "Managing Overconfidence." *Sloan Management Review* 33(2): 7-17

Murray Fulton and Kathy Larson. 2009. "The Restructuring of the Saskatchewan Wheat Pool: Overconfidence and Agency." *Journal of Cooperatives* 23: 1-19

Groupthink

This provocative term was introduced by Irving Janis to describe the tendencies of small, highly cohesive groups to engage in a process of mutual reinforcement of established ideas and understandings. The result, he suggested, is the filtering and discounting of alternative scenarios and the commission of a multitude of uncorrected errors that eventually spawn organizational disasters. As influential as Janis's ideas continue to be, the research record is mixed and public policy studies rarely employ his theories in a disciplined manner.

Irving Janis. 1982. *Groupthink: psychological studies of policy decisions and fiascoes*. Boston: Houghton Mifflin. Selected chapters.

Philip E. Tetlock, Randall S. Peterson, Charles McGuire, Shi-jie Chang, and Peter Feld. 1992. "Assessing Political Group Dynamics: A Test of the Groupthink Model." *Journal of Personality and Social Psychology* 63: 403-42

Paul 't Hart. 1998. "Preventing Groupthink Revisited: Evaluating and Reforming Groups in Government," *Organizational Behavior and Human Decision Processes* 73: 306-326.

Cognitive Dissonance

Cognitive dissonance has its origins in the idea of cognitive consistency, that is people's preference to hold beliefs that are mutually consistent. When evidence arises that two or more beliefs cannot be logically reconciled, various strategies, including ignoring disconfirming information, are deployed to deal with the dissonance. These strategies lead individuals into illogical behavior but they also pose challenges for the creation of public policy. How would you know if this is a serious problem in a particular policy field?

George Akerlof and W. Dickens. 1982. "The Economic Consequences of Cognitive Dissonance," *American Economic Review* 72: 307–319.

Raymond S. Nickerson. 1998. "Confirmation Bias: A Ubiquitous Phenomenon in Many Guises," *Review of General Psychology* 2: 175-220.

VI. Linking Individuals and Organizations: Interests and Identity (Weeks 11-12)

Conflicts of Interest

Debates on conflict of interest have been dominated by legal and philosophical disagreements regarding what constitutes "conflict" and what constitutes "interest." These debates neglect the psychological problems that confront professionals and public sector managers who are obliged to find a decision or policy path that acknowledges political reality but remains untainted by personal gain. The common spectacle of those who veer off that path gives rise to the question: "what were they thinking?" What's the answer?

Ann E. Tenbrunsel and David M. Messick. 2004. "Ethical Fading: The Role of Self-Deception in Unethical Behavior," *Social Justice Research* 17: 223-236.

Mahzahrin H. Banaji, Max Bazerman and Dolly Chugh. 2003. "How (un)Ethical are you?" *Harvard Business Review* December: 56-64.

Nicholas Epley, and Eugene Caruso. 2004. "Egocentric Ethics," *Social Justice Research* 17(2): 171-187.

Jonathon Haidt. 2001. "The emotional dog and its rational tail: A social intuitionist approach to moral judgment," *Psychological Review*. 108: 814-834.

Blake E. Ashforth and Vikas Anand. 2003. "The Normalization of Corruption in Organizations." *Research in Organizational Behavior* 25: 1–52.

Michael Atkinson and Murray Fulton. 2011. "A Cognitive Approach to Conflict of Interest: Policy Responses to the Canadian Sponsorship Scandal," Working Paper, JSGS.

Identity

Well-functioning organizations require co-operation and coordination by the many actors inside and outside the organization. Simon, among others, argues that identity is one of the key forces in creating co-operation and coordination. Identity, of course, is predicated on the presence of groups, since identity requires a sense of being inside or outside of a group. What is identity? How does it influence behaviour? When does identity lead to better decisions within organizations and when does identity lead to poorer decisions.

Herbert Simon. 2000. “Public Administration in Today's World of Organizations and Markets.” *PS: Political Science and Politics* 33(4): 749-756

George Akerlof and Rachel Kranton. 2005. “Identity and the economics of organizations*.” Journal of Economic Perspectives* 16: 9-32.

VII. Organizational Evolution (Week 13)

Although they are often characterized as being static, organizations change and evolve – sometimes successfully and sometimes not. How does this change occur? What is the linkage, if any, between organizational change and the manner in which individuals process information and make decisions? How should an organization go about ensuring that it remains successful? What is the most desirable way for learning to occur in an organization? What is meant by organizational learning?

Kurt Weyland. 2008. “Toward a New Theory of Institutional Change.” *World Politics* 60(January): 281-314

James G. March. 1991. “Exploration and Exploitation in Organizational Learning.” *Organization Science* 2(1): 71-87

RESEARCH PAPER

The purpose of the research paper is to use the insights from the theoretical literature examined above to examine a policy decision where the policy itself or the outcome of the policy was not as expected. Among the issues that can be examined are:

- The creation of the gun registry
- The National Energy Program by the Trudeau government
- The cuts to the GST by the Harper government
- The tainted blood fiasco
- The problem of forecasting potash royalties
- The government’s reversal on income trusts
- The failure to supply a secure supply of isotopes
- The cost overruns and poor performance of e-Health systems
- Low uptake of programs like the Canada Learning Bond and the New Disability Income Support Program.

SUPPLEMENTARY READINGS

Background Reading:

George Akerlof and Robert Shiller. *Animal Spirits*.

Richard Thaler and Cass Sunstein. *Nudge*.

These two books provide good background on behavioural economics and the ways in which it is influencing thinking on a number of major policy issues. While we suggest that students read these books, they will not be formally explored in this course.

EVALUATION

Assignments	15%
Reviews and presentations of articles for class	20%
Research paper on a policy decision	40%
Outline (10%)	
Main paper (30%)	
Final exam	25%
Total	100%

LATE ASSIGNMENTS

All assignments must be submitted by the due date. Please see the instructor if your assignment is going to be late.

STUDENTS WITH SPECIAL NEEDS

All students who have special needs are encouraged to register with Disability Services for Students (DSS). Access to most services and programs provided by DSS is restricted to students who have registered with the office. Once you have registered, please contact the professor to discuss accommodations.

ACADEMIC INTEGRITY AND CONDUCT

Ensuring that you understand and follow the principles of academic integrity and conduct as laid out in the University of Saskatchewan's *Guidelines for Academic Conduct* is vital to your success in graduate school. Ensuring that your work is your own and reflects both your own ideas and those of others incorporated in your work is important: ensuring that you acknowledge the ideas, words, and phrases of others that you use is a vital part of the scholarly endeavour. If you have any questions at all about academic integrity in general or about specific issues, contact your course instructor and to discuss your questions.