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Managerial decision-making in international business: A forty-five-year retrospective

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ABSTRACT

We identify key theoretical developments in international managerial decision-making research, synthesize how they have been employed, and discuss contributions that may emerge as researchers devote increased attention to bounded rationality. Since behavioral factors were first introduced into the international business literature, there has been an increasing trend toward acknowledging the decision makers' role in foreign direct investment and related strategies. However, the reasoning, which explains the characteristics and outcomes of managerial decision-making in the multinational enterprise (MNE), remains implicit and ambiguous. There are a number of potential concerns associated with the assumptions of dominant rational decision-making models and with models that omit decision makers. We highlight these concerns and discuss the benefits of, and opportunities for, models that incorporate bounded rationality, decision-making biases, and judgments by managers.

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1. Introduction

Foreign direct investments require decisions that routinely involve risk and uncertainty, lack of information, and rely on multifaceted organizational processes. MNEs that are better managed may have better chances for survival in the international environment than MNEs with poor management. Yet, forty-five years after the publication of *The Foreign Investment Decision Process* (Aharoni, 1966a), a relatively large segment of international business research continues to leave limited or no room for decision-making on the part of managers. Many models in international business do not take into account the consequences of different decision-making styles on investment decisions, the difficulties in trickling down such styles, or the role of increasing knowledge and experience on foreign environments. Specifically, in most models of entry modes, international expansion or internalization of subsidiaries, decisions are made by organizational units, and most often by MNE headquarters. Headquarter executives in these models tend to choose from a narrow set of options that are outlined in earlier literature. These decision-making options are often based on assumptions originated from the Anglo-Saxon business culture, including specific corporate-level strategies (e.g., global efficiency or local responsiveness) or a defined set of entry modes (e.g., acquisitions, greenfield investments, or joint ventures). Headquarters' decisions about different actions in the international environment in these models are assumed to be precise indicators of the MNE's optimal interest. Actions in these models are also assumed to closely follow distinct organizational strategies, such as multidomestic, global, or transnational. Once strategies are selected, MNEs often implement them without change or variation in their effectiveness.

In most of these models, managers do not have any role (Kogut, Walker, & Anand, 2002). To the extent individual managers are incorporated into conceptual frameworks, they portray rational managers from a pre-Simonian era. Specifically, managers in these studies tend to act based on their own self-interest or, with appropriate governance mechanisms in place, in accordance with interests that are aligned with that of the MNE's owners (see Carpenter, Geletkanycz, & Sanders, 2004; Werner, 2002 for reviews). Interests in these models are translated to international strategies and actions without distortions. The assumption of full rationality by the management of the MNE simplifies the problem of decision-making and shifts the focus from the process to the effectiveness of the MNE governance mechanism. Further, such an omission of the decision maker and the assumption of full rationality may lead to particularly erroneous results: conclusions about MNE actions are generally derived from uncertainty that arises from variation in institutional, cultural, and market conditions across countries and from organizational complexity

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resulting from international expansion. Whereas changes in communication and transportation may offset some of these trends, managerial decision-making continues to be extremely important to MNEs and their stakeholders.

In this article, we review prior international business research regarding the role of managerial decision-making, identify problems associated with the assumption of rationality in decision-making, discuss research that considers behavioral factors for MNE actions, and summarize the seven articles included in this issue. We use our review to outline recommendations for the development of different theoretical perspectives within the field of international business. Furthermore, we attempt to redirect future research toward studying the role of managerial perceptions and the decision-making process in MNE actions.

2. Theoretical foundations of managerial decision-making

Three related areas form the theoretical basis for research on the managerial decision-making process in the MNE. Initial contributions were made by Simon and his colleagues and students, often referred to as the Carnegie School. The central thesis of this line of research is bounded rationality, in contrast to the rational choice model advocated by neoclassical economics. Owing to their cognitive limitations, boundedly rational actors seek satisfactory solutions. Satisfying, as opposed to maximizing, is based on the manager's perception of a complex environment (Cyert & March, 1963; March & Simon, 1958; Simon, 1947). Decision-making in this model is constrained by cognitive ability of the decision maker and is influenced by a wide range of factors, such as personal goals, evaluation criteria, and identity (Certo, Connelly, & Tihanyi, 2008). Findings of the Carnegie School were derived from empiricism or ''administrative experiments'' (Dasgupta, 2003). Shifting the focus from earlier theoretical models of microeconomics to the empirical study of organizational settings has led to a more realistic picture of the managerial decision-making process.

A second line of research has demonstrated that human cognitive processes are intended to reduce cognitive effort through the use of heuristics that create systematic biases (Kahneman & Tversky, 1979). Much of the recent work integrating behavioral decision theory into the organizational literature has been based upon the principles of prospect theory (Slovic, Fischhoff, & Lichtenstein, 1977; Tversky & Kahneman, 1974). This line of work has devoted significant attention to explaining cognitive biases, which are a form of heuristics that typically result in inaccurate judgments. The search for new and increasingly complex biases and heuristics has continued in studies (e.g., Gilovich, Griffin, & Kahneman, 2002; Kahneman, 2003), with significant attention to the problems of managerial decision-making (Miller & Chen, 2004; Schwenk, 1995).

According to prospect theorists, the framing of an outcome or a decision by economic agents affects the utility that these agents expect. In particular, given the same variation in absolute value, there is a bigger impact on the decision maker for losses than there is for gains. Thus, decision makers may be more risk averse when they frame a strategic decision as potential for loss and less risk averse than when a decision is framed as potential for gain (March & Shapira, 1987; Miller & Chen, 2004). Evaluations around losses and gains in prospect theory are developed starting from some particular reference point. The utility function takes different shapes on either side of this reference point, which is in contrast with the additive utility underlying neoclassical economics. From this perspective, a manager's choice of reference points plays an important role in subsequent decision-making. Risk preferences above the reference point will be greater than risk preferences below. These reference points are selected based upon internal capabilities and external conditions considered over time (Shoham & Fiegenbaum, 2002).

A third area of research contributing to the theoretical foundations of managerial decision-making lies at the intersection of psychology and economics (e.g., Arieli, 2008; Rabin, 1998; Thaler, 1991). This stream of behavioral economics advances the earlier findings of the Carnegie School and behavioral theory. This line of research has challenged conventional economic analysis that rests on mathematical formalization and methodological individualism and has started to add significant behavioral findings to today's mainstream economics (Rabin, 2002). Rabin (1998), for example, examines the role of learning and expertise in reducing decision-making biases. Other areas of research by behavioral economists include reference levels, anchoring, and altruistic behavior. Considering the traditional influence of economic theories on the evolution of international business models, findings of behavioral economics are expected to generate new research on managerial decisions in the MNE.

The three related areas described provide effective answers to a number of important anomalies in neoclassical economics and in related organizational fields. Although many researchers continue to use rationality assumptions in their models, bounded rationality, cognitive limitations, biases, and other behavioral findings suggest that models relying on choices made by rational decision makers are no longer coherent (e.g., Kuhn, 1962). New findings on the decision-making process have led to a paradigm shift in economics and organization science, with important consequences for the field of international business (Dasgupta, 2003; Rabin, 2002). In the next section, we provide a brief overview of international business research regarding the role of managerial decision-making. Our overview concentrates on three main approaches to decision-making research, including behavioral models of foreign investment decisions, decision frameworks with the implicit assumption of bounded rationality, and models that are based on the notion of full rationality.

3. Managerial decision-making and international business

3.1. Behavioral perspectives of the MNE

Behavioral explanations of foreign direct investment appeared relatively early in international business research. *The Foreign Investment Decision Process*, published in 1966, outlined a model of internationalization that focused on the role of managerial decision-making. It outlined a perspective that sought to answer the questions ''what motivates managers to make a foreign investment decision'' and ''how do MNE managers make foreign investment decisions under environmental uncertainty?'' The stated aim of the behavioral theory of foreign investment was to identify the variables that influence the managerial decision process in order to explain the process itself. From this perspective, foreign investment decisions were examined at the group level, but with greater emphasis on individual members within the group who are responsible for making the decision to invest abroad. Five elements of the decision process were delineated:

- The social system in which the process takes place.
- Time over which the process occurs.
- Perception of uncertainty surrounding the decision, and risk propensity of decision makers.
- Interaction of the goals of managers, business units, and the organization as a whole.
- Constraints on the actions of the decision maker.

The Foreign Investment Decision Process discussed two of these elements in depth: uncertainty and the social environment.

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