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Henrich R. GREVE  
*INSEAD*

Cyndi Man ZHANG  
*Singapore Management University, cyndizhang@smu.edu.sg*

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# Is there a strategic organization in the behavioral theory of the firm?

## Looking back and looking forward

**Henrich R Greve**

INSEAD, Singapore

**Cyndi Man Zhang**

Singapore Management University, Singapore

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### Abstract

In the 20 years of *Strategic Organization*, how well has knowledge drawn from the behavioral theory of the firm contributed to the field of strategy? We see progress both in the pages of *SO!* and elsewhere in the field of strategy, but this progress has been held back by divisions between strategy and organization theory in what theories should predict, what mechanisms are preferable predictors, and what outcomes are of interest. Despite these divisions, the last few years have seen particularly rapid progress, turning the behavioral theory of the firm into one of multiple organization theory sources of strategy knowledge. It is time to reassess and consider the best future direction, and we propose a framework organized around how strategy is shaped by the (1) organizational structure, (2) organizational decision makers, (3) organizational history, and (4) organizational environment. This subdivision captures the decision-making units in the theory (1–2), the importance of experience (3), and the role of context (4). We outline fruitful research topics based on this framework.

### Keywords

Behavioral strategy, behavioral theory of the firm, decision making, diffusion, organizational learning, organizational memory, topics and perspectives

A comprehensive review of research based on the behavioral theory of the firm published 10 years ago devoted two pages to strategy under the title “Extensions,” with a central argument being that very little of the significant research stream based on the behavioral theory of the firm was related to strategy (Gavetti et al., 2012: 26–28). Recently, the review by Davis and DeWitt (2021) made the related point that the fields of strategy and organization theory rarely interact. If these assessments are correct, it seems fair to ask whether there is, or can be, a strategic organization—an

Corresponding author: Henrich R Greve, INSEAD, 1 Ayer Rajah Avenue, Singapore 138676, Singapore. Email: [henrich.greve@insead.edu](mailto:henrich.greve@insead.edu)

organization that acts strategically—in the behavioral theory of the firm. In the following, we answer affirmatively, though we warn the reader that this answer is biased by our long-standing liking of both fields and our attempts to contribute to the fields of strategy and organization theory, often in one and the same paper. To support our affirmative answer and inspire new research, we outline research topics that address organizations' strategic outcomes and can be effectively addressed by the behavioral theory of the firm.

A good starting point is that Strategic Organization (hereafter SO!) has articles that combine the two to make strong contributions. The individual-level foundations of the behavioral theory of the firm (hereafter BTF)<sup>1</sup> has been extended with research showing how individuals have different approaches to problemistic search (Banerjee et al., 2019). The organizational behaviors hypothesized in BTF have been supported and extended by research on how firms explore when entering new product markets (Hoang and Ener, 2015). The theory on firm risk taking, itself an extension of BTF, has been developed further and yielded additional hypotheses (Klingebiel, 2018). Performance relative to aspiration levels has been shown to influence strategic repositioning along with industry conditions, as specified in performance feedback theory (Schimmer and Brauer, 2012), and there has been a meta-analysis of findings from performance feedback research (Kotiloglu et al., 2021). Organizational and individual level theory has been merged to form theory on how performance feedback and risk taking is influenced by the top management team, with supporting evidence (Kolev and McNamara, 2020). These are valuable contributions, and additional work can be found in articles that involve the BTF but do not make it the main thrust of the argument. Still, it is a concern that so few BTF-strategy articles have resulted from 20 years of SO!

Is the same true for other strategy journals with an interest in strategy? *Strategic Management Journal* (SMJ) has seen an increase of articles based on BTF. Performance feedback research in SMJ includes work on how goal effects function differently depending on the hierarchical level of organizations (Gaba and Joseph, 2013) and how problemistic search is directed toward resource-freeing actions when the organization has few slack resources (Kuusela et al., 2017). There is also work on how BTF can predict market entry (Ref and Shapira, 2017), and on how middle managers react to performance feedback by finding and championing new strategic initiatives (Tarakci et al., 2018). These are just examples because the sheer number of articles in SMJ, which is a large journal, is too high to treat each article separately. The recency of these papers is noteworthy, however, and 2021 also has good examples (Billinger et al., 2021; Dong, 2021). The increased interest means that a journal does not need to be devoted to conjunction of strategy and organizations to see the importance of connecting strategy to BTF—a generalist strategy journal will do the same. It also means that it is time to ask what the best connection of BTF and strategy is, and what SO! can do to make this connection.

## **Can BTF become a theory of a strategic organization?**

The problems inherent in connecting BTF and strategy are easy to identify. Although the field of strategy has largely moved away from prescriptive theory outlining how firms can best win competitive battles of various kinds, it still has a strong forward-looking emphasis that differs greatly from how most BTF research emphasizes learning from experience (but see Gavetti and Levinthal, 2000). Although the field of strategy is less focused on modeling the determinants of firm performance than it was earlier, there is still a distinct division between the great interest in various performance measures in strategy (e.g. Davis and DeWitt, 2021; Ray et al., 2004) and the emphasis on predicting behavior in BTF research and organizational theory generally. With different interests in the dependent variable and the theoretical mechanism, how can BTF contribute to strategy?

The answer can be found by examining how the field of strategy and BTF has been extended recently. In strategy, there is increased recognition that more theory development on the mechanisms underlying predictions on firm actions and outcomes is needed. The microfoundations movement (Felin et al., 2015) has made many behavioral theories of strategy more prominent, including BTF. At the same time, BTF research has seen an influx of studies that emphasize predictions of organizational actions that are so consequential that they form the firm strategy, and in some cases, the studies explicitly seek to make a strategic BTF (e.g. Kuusela et al., 2017; Xie and O'Neill, 2014; Zhang and Greve, 2019).

This is a major development. Historically, BTF research has been focused on the organizational mechanisms investigated, and scholars have paid much less attention to whether the outcomes used as dependent variables are strategic, operational, or symbolic. Product-market choice is an important part of strategy, yet the early tests of BTF's performance feedback theory did not emphasize the strategic significance of studying organizations changing market position (Greve, 1998) or launching innovative products (Greve, 2003). Much of the later work in this research stream has been similarly agnostic about the strategic significance of the findings, but recent work has made more efforts to integrate strategic considerations. For example, Kuusela et al. (2017) built theory to show how strategic considerations shaped the actions taken after negative performance feedback and provided evidence supporting it. Obloj and Zenger (2017) documented the adverse performance consequences of making explicit performance comparisons among competing organizational units.

These examples indicate a trend of BTF and strategy-making extensions toward each other, suggesting that the field is ready for a theory of strategic organization built on BTF considerations. No doubt this type of theory will involve extensions to make predictions that are more explicitly strategic, and to confront and incorporate new evidence suggesting necessary changes to the theory. The future will show how these changes develop. Observing these trends and declaring (future) victory is not enough, however, because it leaves unanswered the questions of what would be the best kind of strategic BTF. This question is difficult to answer in advance, but we devote the rest of this essay to making some suggestions.

## **What questions can BTF answer as a theory of a strategic organization?**

The central role of BTF in the study of strategy is to predict how organizations choose strategic actions. At its heart, BTF is a theory of decision making in organizations, which exactly fits a goal of predicting strategic choices. It is not as good a fit to goals of examining performance outcomes from strategic choices because BTF has a central assumption of boundedly rational decision makers who are able to observe and assess only parts of the relevant current environment, not to mention the future environment in which strategies are implemented. BTF does not assume that managers are naïve and uninformed, but rather the assumption is that a boundedly rational decision maker seeking to beat other boundedly rational decision makers may not become a clear winner or loser.

The main thrust, then, will always be on predicting the choice of strategic actions. When outlining how BTF can predict organizational strategies, it is useful to organize the outline by central concepts in the theory. Here, we examine the organizational structure, decision makers, history, and environment. All of these have been central to BTF from the start and hold significant promise for additional research.

### *Consider the structure of the organization*

Organizations are structured through division into subunits, as discussed by March and Simon (1958), and they are also structured through goals assigned to different individuals and groups (Cyert and March, 1963). Goals trigger and direct search, and subunit structures determine who is responsible for the search (Greve, 2018). Examination of organizational structure has been surprisingly slow given the great interest in structures in early organization theory (e.g. March and Simon, 1958), and perhaps also because the list of questions to explore is surprisingly long. What are the structures that matter most for organizational learning—horizontal differentiation, hierarchical authority, or information flows more generally? How do goal structures interact with organizational structures? These questions combined with the problem of accurately observe goals and organizational structures create significant barriers to research.

Nevertheless, in learning about structure, BTF research has made significant advances. The effect of goals and performance feedback on organizational changes is well established, and there is theory but so far limited evidence on the effects of organizational formalization and power structure (Audia and Greve, 2021). We already know, however, that the combination of authority and power structures with goals affects organizational learning (Gaba and Joseph, 2013). Similarly, organizations have spatial structures through the location of their subunits, and these determine the availability of knowledge that can be used for strategic actions (Chakrabarti and Mitchell, 2013; Giuliani and Bell, 2005). Organizations have temporal structures that can toggle between committing resources to make backward-looking adaptations and implementing forward-looking strategies (Gao et al., 2022). Organizations have network structures formed through collaborations and transactions, and these shape the information available and attended to in ways that influence strategic actions (Greve, 2009; Kale and Singh, 2007). The difficulty inherent in a complex organization learning from a complex environment has been recognized (March et al., 1991), and the benefits of simplifying the organization accordingly have been measured (Wezel and Ruef, 2020).<sup>2</sup>

A range of research questions can be asked based on structural considerations, ranging from the simple and fundamental to more complex ones. Do centralized firms respond more strongly or weakly to reduced performance? Are they better or worse at retaining lessons from past competitive battles? Does decentralization of goal structures make firms more or less responsive to opportunities or threats? Does it enable more rapid interpretation of changes in the environment? These are all questions that fit the agenda of the BTF.

The BTF shows how an organization maintains its strategic position by structuring to address specific goals and ignore others. Even when organizations share goals, they address problems differently because the search for a solution to problems (or pursuit of opportunities) happens in a context, and the structuration of an organization into subunits that exchange information shapes this context (Schulz, 2001). Similarly, decisions are made by managers occupying specific roles and holding responsibility for specific goals (e.g. Bidwell and Keller, 2014; Fligstein, 1987) and these goals naturally differ within and among organizations. Organizations have different objectives.

### *Consider the decision makers of the organization*

They are the ones who direct search and decide actions based on solutions that have been found. It is a central part of the BTF that decisions are made in groups, and the members of a group will have different preferences that they seek to advance, while the group as a whole seeks some degree of unity. The solution to this theoretical problem is the concept of the dominant coalition, which is the majority (possibly weighted by authority rules) formed around advocating a specific alternative

(Cyert and March, 1963). The same dominant coalition may re-form as new choices are made, but it is also possible that members come and leave depending on the alternatives, at times leaving most of the old dominant coalition members outside the new one. This is a realistic view of how decisions are made, but it is also a complicated one that appears to require more data than scholars usually have access to. How do organizations form coalitions and agree (or contest) as the organization seeks to solve strategic problems? This is a political process, but managers are not politicians with clearly defined parties and agendas. What lines divide them, and how do they organize around these lines?

BTF's concept of a dominant coalition is an interest contrast to and extension of strategy research on top management and boards of directors. It has long been known that the background of CEOs has significant implications for firm strategies (e.g. Fligstein and Brantley, 1992). While CEO characteristics of various kinds have seen much examination among management scholars (e.g. Chatterjee and Hambrick, 2007; Hayward et al., 2004), an essential part of the behavioral theory of the firm is to investigate decision-making groups, at the organizational apex or further down. It is becoming established that the background of decision managers in the top tier of organizations affects their choices among different actions (Zhang et al., 2022; Zhang and Greve, 2019), including decisions to abandon practices (Gaba and Dokko, 2016). Subtle differences in experience can be remarkably powerful, with simple priming producing changes in the composition of corporate boards (Seidel and Westphal, 2004). When such subtle differences can produce not only changes in organizational actions but even in the organizational structure making changes—the composition and network of the board of directors—it is no wonder that powerful influences such as the background, training, or work experience of decision makers leave a strong imprint on firm behaviors (e.g. Luo and Chung, 2005; Ndofor et al., 2015).

The conclusion following from this research is that future actions are shaped not only by the past of the organization, but also by the past of its decision makers, including their formative experiences before joining the organization. What kinds of experience are most important for shaping managerial decision making? Is it the mental framework gained through occupational training, the lessons learnt from early managerial experiences, or something else? How are the experiences from different decision makers integrated when making decisions as a team? To put the question concretely, what composition should a team deciding new or innovative product launches have in order to make good decisions? Is the manager hired from a very innovative firm especially valuable? Or the manager with no prior product launch experience but engineering training? Questions like these naturally follow from an emphasis on decision makers and should be emphasized in future research.

The BTF has always been a theory populated by managers using their experience to solve problems (usually) and pursue opportunities (sometimes). It is a central part of the theory that different managers and decision-making groups will make different decisions, not because of their intrinsic differences but because of their different experiences. The idea that the experiences of an organization shape the organization overall and those in it, possibly spilling over into other organizations as they change work, has not been investigated as much as it should be. For the field of strategy, the BTF demands close attention to how the leadership of an organization is multiple people blending their experience from multiple past workplaces. How an organization chooses among alternatives is shaped by their experiences and resulting preferences. Organizations have different minds.

### *Consider the history of an organization*

A central point of the BTF, which later became a defining feature of organizational learning theory (Levitt and March, 1988), is that understanding how an organization behaves requires

understanding its history. Past and future are intimately connected. The problems an organization has encountered, the solutions it has tried, and the results of applying these solutions condition the future responses (Cyert and March, 1963: ch. 6), just as path-dependence is seen across a broad range of organizational behaviors and outcomes (Arthur, 1989; Berg, 2022; Greve and Seidel, 2014). To many empirical researchers, this sounds like a theory that is easy to formulate and difficult to test. How can a researcher keep track of an organization's history of taking actions to solve problems? Organizations act all the time, but only some of the actions become learning experiences that shape future actions. How can they be identified, and how can the successes and failures of these actions be recorded by an outsider, especially if they are subject to internal interpretation?

These are good questions, but we already know that empirical researchers have made progress through making reasonable assumptions and obtaining high-quality data. The near-accident experiences by airlines studied by Haunschild and Sullivan (2002) supported the learning process formulated in the behavioral theory of the firm and added significant detail on the effect of different learning sources on behavioral changes. Eggers (2012) demonstrated that specialized learning is easier than generalization, though organizations are capable of both. Perkins (2014) showed the key role of similarity in learning processes by demonstrating that organizations transfer lessons much more effectively between similar contexts.

History-dependent strategic action has been studied for some time, most notably in the literatures on firm exploration and exploitation (Lavie et al., 2010) and path-dependence in firm innovations (e.g. Christensen, 2000; Khessina and Carroll, 2008). Much more can be done, however, to explore how a firm's history enables or constrain its future actions. Does a history of failed product or market entries constrain future actions of the same kind, or do they provide knowledge useful for future entries? Do firms learn specific responses to competitive challenges and repeat them over time? What kind of history can produce novel strategic actions?

The BTF shows how organizations become different, and maybe even unique. Each has a distinct history, which shapes the problems its decision makers identify and the solutions they apply. This allows the analyst to take a step away from a game-theoretic conception of strategy as a game played by identical participants seeking to outsmart one another through finding positions and gaining advantages through first or late-mover stratagems. Instead, organizational strategies are formed through learning, and organizations become strategic in different ways because each had distinct approaches to solving problems and pursuing opportunities. Organizations have different habits.

### *Consider the environment of the organization*

It is common knowledge that the switch to an environmental focus in organizational theory took place in the 1970s (Scott, 1987), after Cyert and March (1963). It is less well recognized that because search for solutions was a central focus of Cyert and March (1963), the book contained theory on the initiation of search and case studies on how search proceeded to a decision (or non-decision). It would be fair to say that the BTF researchers have paid more attention to how search is initiated than to how it proceeds, as recent theoretical work has added goal structures and decision-maker power and cognitions to search theory, with the environment only having a minor role (Greve, 2018). What can be done to address this gap in the theory? A starting point is to recognize that for the BTF, the environment is best conceptualized as a source of information that may influence decision making. Organizations encounter the environment in the form of institutions and markets (Scott, 2001), and what guides the decision making is how these are interpreted and form expectations (Cyert and March, 1963).

The groundwork for such work was done when Levitt and March (1988) discussed learning from the experience of others as an important process. The idea is simple and powerful; an environment in which certain solutions are abundant or salient will make adoption of these solutions more common, which means that the rich literature on the diffusion of (strategic) innovations (e.g. Naumovska et al., 2021) are part of the expanded BTF. Diffusion studies are prevalent across so many fields of research, so it is important to keep in mind what distinguishes a BTF diffusion study. The diffusion process creates an environment that makes a specific strategic change more likely, but the premise for any kind of change is that the organization is searching for solutions, and usually also that it cannot find a ready-made solution in its history. As a result, diffusion processes are especially important for organizations that fail to meet goals (Ahmadjian and Robinson, 2001; Wezel and Saka-Helmhout, 2006).

The effects of the environment go far beyond diffusion processes. There is a significant research stream on how organizations put together knowledge from their environment, often defined geographically, and use it to produce their own innovations (Funk, 2014; Vestal and Danneels, 2022). The research stream on innovations has not yet examined carefully whether this is a search process triggered by failure to reach goals or a routine activity by organizations. What kind of technology environments produce more strategic changes, or more novel strategic changes? Similarly, there is work on how firms learn from their institutional environment (Greve and Zhang, 2017), but generally the combination of institutional constraints and firm strategy formation has seen less attention because the two phenomena attract different researchers (Davis and DeWitt, 2021). Do restrictive institutional environments prevent firms from making strategic changes, or do they redirect strategic action, perhaps toward exploiting the institutional environment?

The BTF stated a range of unanswered questions on firm decision making under the header “Decision making within strategies,” including “What determines which sources of information will be used by an organization?” (Cyert and March, 1963: 20). This is a natural question for a theory emphasizing the consequential decisions that form organizational strategies and operations. It implies an interest in the organizational environment, and so does the emphasis on goals with aspiration levels set through comparison with peer organizations and search processes that are conducted both internally in the organization and externally in the proximate environment. There is already much research on the components of a BTF that includes environmental concerns, and we will soon see research that puts them together. Organizations live in different places.

## **Does SO! have a role?**

The growth of research establishing these four features of the strategic organization is obviously not dependent on any single journal. Nor can it be. The necessary research streams are too large to be accommodated by any single journal. That does not mean that this theoretical and empirical agenda is a free-for-all where SO! has no special role. The mission of SO! as a journal that examines the intersection of organization theory and strategy means that it should become a pioneer in advancing this research. Because the topics in this agenda are pioneering and may be difficult to accomplish empirically, researchers embarking on them have two problems. First, as in any kind of pioneering research, they are in a race to be the first to publish their theoretical advances and get cited for them. Second, as in all current management research, they are facing increasingly strict empirical requirements, which holds back papers that make strong theoretical advances but have weaker empirical support (Sutton and Staw, 1995).

Making theoretical progress based on BTF on these topics is not difficult, so it is likely that major areas of progress in research may be held back by empirical problems—specifically, difficulty in gaining data access and an absence of good template studies. This is partly a result of the



type of data required. For examining the effect of structures, for example, the formal organizational structure and/or the decision-making process should be measured, but research doing this is less common than it should be. Progress in such measures would be essential for BTF and helpful to other research streams focused on strategic decision making. Similar challenges are found in characterizing the decision makers and their context, identifying the parts of organizational history that influence organizational actions, and the environmental features that the organization reacts to. Making progress in these areas is a task for researchers, but encouraging it is a task for journals.

We suggest that SO! may become the journal that drives research on the BTF and strategy forward by being particularly friendly to this type of research. Although the proposition that novel theory should allow journals to publish research with slightly weaker methods than usual (e.g. Sutton and Staw, 1995) is not universally accepted, a journal can certainly make such assessments when the theory is not only novel, but also positioned centrally in its mission. Making such decisions puts new theory in print and encourages additional empirical testing. It lowers the entry barrier for researchers with great ideas and lets the theory grow faster. Along with the theory, the scope of empirical testing will also expand and add to our knowledge. SO! is ideally positioned to become a key place for the behavioral theory of the firm to grow into an even greater part of the field of strategy.

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### ORCID iD

Henrich R Greve  <https://orcid.org/0000-0002-7927-6573>

### Notes

1. With apologies—the authors are not fans of abbreviations, and understand that many others are not either.
2. These are selected examples, not a complete list. The same is true for papers cited in the following paragraphs.

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### Author biographies

Henrich R Greve is the Rudolf and Valeria Maag Chaired Professor of Entrepreneurship at INSEAD. His current research interests include performance feedback in firms with multiple goals, diffusion of innovations, organizational responses to crises, and the propagation and effect of COVID-19 conspiracy theories. His work has appeared in journals such as *Administrative Science Quarterly*, *Academy of Management Journal*, *Academy of Management Annals*, *Strategic Management Journal*, *Organization Science*, *American Journal of Sociology*, *American Sociological Review*, *Journal of Management*, *Strategic Organization*, and *Journal of International Business Studies*. Address: INSEAD, 1 Ayer Rajah Avenue, Singapore 138676, Singapore. [email: henrich.greve@insead.edu]

Cyndi Man Zhang is an Associate Professor of Strategic Management at the Lee Kong Chian School of Business, Singapore Management University. Her research builds on the intersection of behavioral theories and institutional theories to examine the influence of institutional logics on firms’ strategic choices, the impact of corporate governance on innovation performance, the power struggle and coalition building in strategic decision making, and the pursuit of multiple goals in firm’s decisions of change. Her work has been published in the *Academy of Management Journal*, *Journal of Management*, and *Advances in Mergers and Acquisitions*. She currently serves on the editorial board of the *Academy of Management Journal*, *Strategic Management Journal*, *Strategic Organization*, and *Management and Organization Review*. Her research has also been covered by mainstream business media such as LSE Business Review and Forbes. Address: Singapore Management University, 50 Stamford Road, Singapore 178899, Singapore. [email: cyndizhang@smu.edu.sg]