



**THE TRANSFORMATION OF ECONOMIC AGENTS' BEHAVIORAL  
FUNCTIONS AS A BASIS FOR RETHINKING FIRM MANAGEMENT**

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*This article examines the role of behavioral theory in understanding how firms operate and make decisions in a changing economic environment. It explores the concept of the firm, its main objectives, and its key areas of activity, including production, commercial, financial, and consulting operations. Particular attention is paid to the behavioral approach developed by Herbert Simon, Richard Cyert, and James March, which challenges the traditional assumption that economic agents always act rationally and seek to maximize their benefits. The article highlights the influence of limited information, human capabilities, personal interests, social norms, and organizational relationships on managerial decision-making. It also considers how the different goals of employees, managers, owners, and shareholders shape a firm's strategies and daily operations. The study emphasizes that understanding actual human behavior is essential for developing more realistic economic models and improving management practices. It concludes that incorporating behavioral factors into the theory of the firm provides a more comprehensive understanding of organizational decision-making and helps explain how firms adapt to changing market conditions.*

The term "firm" emerged at a specific stage of socio-economic development and is linked to a particular type of economy - specifically, market relations. Although the modern



understanding of the term is associated with the market, the concept itself has roots that reach far back into the past. A firm is an independent economic entity that conducts business operations within a market economy. Its primary objective is the production and sale of goods or services to satisfy consumer needs and generate income.

A theory is a system of fundamental ideas that generalizes experience and reflects objective patterns; it performs explanatory and predictive functions regarding natural, social, economic, and other phenomena.

The theory of the firm is a branch of economics that studies the principles of enterprise operation, decision-making processes, and market behavior. It enables the analysis of a firm's decisions regarding production volumes, pricing policy, investment, income distribution, and other areas of activity.

A firm may simultaneously engage in the production of goods, their promotion to buyers, and direct sales, while sometimes also providing financial and consulting services. Its primary objectives include generating income for its owners; paying employee wages; remitting taxes to local and state budgets; creating jobs for the local population; protecting the environment; and ensuring uninterrupted operations and the steady supply of products to consumers in accordance with contracts and market demand.<sup>2</sup>

The source of a firm's funds consists of resources provided by households in exchange for factor income (a firm's own funds can also be viewed as resources provided by its owners - households). Households and the state also act as purchasers of the firms' output. When a firm utilizes resources owned by its proprietors, payment for the factors of production is implicit or hidden; conversely, when a firm obtains resources from external parties, payment for the factors of production becomes explicit.<sup>3</sup>

The activities of firms are diverse, yet they are typically categorized into four types:

Production activity is directly linked to the creation of goods and services. To maintain a competitive edge, enterprises must not only sustain existing technologies but also implement new solutions. Innovation enables firms to adapt to changing demand and create products with new characteristics.

Commercial activity carries higher risk than production activity. This heightened risk stems from the volatility of market conditions; the transport of goods over long distances, along with associated loading, unloading, and warehousing operations - which pose challenges for product preservation and can lead to changes in quality or even quantity during transit and storage; and a lower degree of reliability regarding adherence to contractual terms for delivery schedules and payments. Consequently, commercial activity requires a higher rate of return compared to production activity. A manufacturing firm may handle sales itself; such activity is known as

<sup>2</sup> Theory of the Firm: V.N. Smagin. – Chelyabinsk: SUSU Publishing Center, 2010. – 13 p.

<sup>3</sup> Tumashev A.R., Kotenkova S.N., Tumasheva M.R., Economic theory. Part 1. Introduction to economic theory. Microeconomics.



production-and-commercial activity. However, for a medium-sized firm and especially for a large one - combining these activities is often not economically justified.

Financial activity (from the Latin «financia»—cash, income) arises at the monetary stage of capital circulation, where the commodities involved are cash and non-cash funds, foreign currency, and securities. Money can rapidly lose value due to inflation, while securities can undergo swift price fluctuations and exhibit significant discrepancies between their nominal and real values. The substantial risk inherent in financial activity accounts for its potentially high profitability—exceeding that of production or commercial operations.

Consulting activity aims to reduce uncertainty in entrepreneurial decision-making and enhance the effectiveness of those decisions. Consulting firms analyze situations and provide recommendations on a fee-for-service basis across a wide range of areas, including legal matters, financial management, tax optimization, marketing, strategic management planning, technology, human resources management, business process reorganization, and more.

Among all types of activities, production plays the leading role, since goods must be produced before they can be exchanged and consumed. However, the ease of distributing goods and the convenience of consumption depend on the level and quality of intermediary activities, trade, and the financial market.<sup>4</sup>

#### Behavioral Theory of the Firm

Herbert Simon is a key figure in the behavioral approach. Unlike the classical model, which assumes that an economic agent is capable of finding an optimal solution, Simon emphasized the limitations regarding information, time, and human analytical capacity. Consequently, in real-world situations, the decision reached is not necessarily optimal but rather acceptable - aligning with the organization's existing conditions and capabilities.

At the heart of behavioral theory lies the decision-making process of economic agents facing information volumes that exceed their processing capacity, as well as the impact of these decisions on a firm's development and market behavior. Behavioral theory seeks to examine the activities of economic actors in real-world situations - without the presumption of economic rationality - within a market dominated by conventional rather than rational behavior; such behavior is governed not only by objective functions like utility or profit maximization but also by established rules and conventions, taking into account traditions, culture, mentality, social norms, and developed standards.

The further development of the behavioral approach is associated with the research of R. Cyert and J. March. They viewed the firm not as a single entity with a unified goal, but as an organization within which various groups of participants interact. Employees, managers, and owners may have differing interests; consequently, the firm's final decisions emerge from the interaction and reconciliation of their respective positions.

<sup>4</sup> Smagin, V.N. – Theory of the Firm. – Chelyabinsk: South Ural State University Publishing Center, 2010. – p. 17.



To make decisions within the Cyert-March behavioral model, the firm forecasts demand for its products and competitor behavior, estimates costs, and formulates goals.

The conclusions reached by R. Cyert and J. March in their research are as follows:

1. A firm's search for information is not a regular activity but rather an exceptional measure, undertaken only when existing organizational solutions have proven ineffective under changing conditions.

2. Proposed new courses of action are not compared against one another but against existing solutions; they are evaluated based on their alignment with key operational parameters—primarily whether the firm's budget contains the necessary funds for the project and the associated changes.<sup>5</sup>

Behavioral theory is based on the premise that a firm has multiple goals. This set of goals includes:

- the interests of workers seeking high wages, good working conditions, and workplace safety;
- the interests of managers seeking power, higher social status, career advancement, and increased income;
- the interests of shareholders desiring high dividends;
- the interests of the firm's top management, who aim to improve the company's economic performance and enhance its prestige.

Behavioral theory posits that task setting is imperfect—meaning new goals do not always align with current policy—and that tasks are formulated more as objectives to strive for than as maximization problems; furthermore, these goals become more complex or simplified in light of experience.

Behavioral theory also addresses communication issues in large organizations, positing that the decision-making process is distributed throughout the firm rather than concentrated at the top of the organizational pyramid. This is because lower-level managers do not merely execute orders but also exercise initiative by (a) fleshing out the broad plans outlined by senior management and (b) synthesizing information to be passed upward, serving as the basis for their superiors' decisions.

#### Conclusion

Behavioral theory plays a significant role in the development of economics, as it acknowledges that individuals do not always act rationally or in accordance with assumed models of economic behavior. Traditional economics posits that people always make decisions by maximizing their utility and acting based on rational expectations. Behavioral economics, however, examines how real people make economic decisions, taking into account their bounded rationality, inconsistent preferences, and the influence of their social environment. The importance of behavioral theory includes:

<sup>5</sup> Udalov D.V. Theory of the Institutional Evolution of the Firm. Saratov, SGSEU Publishing House, 2008. 268 p.



1. Explaining inconsistent behavior: Behavioral economics examines the causes of behavioral inconsistency, such as the principles of emotional influence and factors affecting risk-taking. This enables us to better understand why people make decisions that do not always maximize their own benefit.

2. Improving the understanding of consumer preferences: Behavioral economics investigates the consumer decision-making process, taking into account emotions, perceptions, and the social environment. This allows for a better understanding of the factors influencing consumer choices and facilitates the offering of a more diverse range of products and services.

3. Development of economic models: Behavioral economics complements traditional economic models by allowing for the consideration of a broader range of factors influencing decision-making. This enables the creation of more realistic models and more accurate predictions of human behavior in economic situations.<sup>6</sup>

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<sup>6</sup> I.F. Yarullin – Managerial Activity and Management, 2019.