

# Successful Decision-making

Rudolf Grünig · Richard Kühn

# Successful Decision-making

A Systematic Approach to Complex Problems

Second Edition

Translated from German by Anthony Clark and Claire O'Dea

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## **Preface for second edition**

In the second edition, a new chapter about decision sequences and a glossary have been integrated. Furthermore, to increase the conciseness, the chapters 6 and 7 have been revised.

The authors would like to express their thanks to Phuong Tu Le for her substantial work in preparing the manuscript for this edition. The authors would also like to thank Anthony Clark for translating the new chapter and the glossary.

February 2009  
Rudolf Grünig, Richard Kühn

## **Preface**

The executives of companies, non-profit organisations and governmental departments are regularly confronted with important decision problems. These problems are typically highly complex and therefore difficult to resolve.

The aim of this book is to support the management in successfully solving complex problems. At the center of the book is a procedure for approaching any complex decision problem. The procedure consists of steps which are explained in detail and illustrated with examples.

This book could not have been produced without the effort and the considerable talents of Anthony Clark and Claire O'Dea who translated the text from German into English. The authors address their great thanks to the two translators for their excellent work. Phuong Tu Le deserves special thanks for her effort in putting together the book by typing the manuscript and designing the figures.

January 2005  
Rudolf Grünig, Richard Kühn

# Brief contents

Preface .....	v
Brief contents .....	vii
Contents .....	ix
List of figures .....	xiii
List of insets .....	xix
 Introduction.....	 1
 Part One: Decision problems and decision-making procedures .....	 5
1 Decision problems.....	7
2 Goal and problem-finding systems as requirements for the discovery of decision problems .....	17
3 Rational decisions .....	29
4. Decision-making procedures.....	41
 Part Two: A general heuristic decision-making procedure .....	 57
5 Overview of the decision-making procedure .....	59
6 Discovering and analyzing the decision problem .....	73
7 Developing and evaluating options .....	91
8 Establishing the overall consequences of the options and making the final decision.....	115
9 A case study illustrating the application of the procedure .....	149
 Part Three: Special issues and approaches to resolving them.....	 171
10 Decision sequences.....	173
11 Information procurement decisions .....	185
12 Collective decisions.....	197
 Final remarks.....	 219
 Glossary .....	 221
Index .....	229
Bibliography.....	235

# Contents

Preface .....	v
Brief contents .....	vii
Contents .....	ix
List of figures .....	xiii
List of insets .....	xix
 Introduction.....	 1
 Part One: Decision problems and decision-making procedures .....	 5
1 Decision problems.....	7
1.1 The decision problem .....	7
1.2 Ways of solving decision problems .....	7
1.3 Types of decision problems.....	10
2 Goal and problem-finding systems as requirements for the discovery of decision problems .....	17
2.1 The functions of goal and problem-finding systems in the discovery of decision problems.....	17
2.2 Goal systems.....	18
2.2.1 Goal systems as combinations of single goals.....	18
2.2.2 Approaches to classifying goal systems .....	19
2.3 Problem-finding systems .....	22
3 Rational decisions .....	29
3.1 The sequence of events in decision-making procedures as a framework for rational decisions .....	29
3.2 The requirements of a rational decision process .....	35
3.3 Support for rational decision making from management science .....	39
4. Decision-making procedures.....	41
4.1 Decision-making procedure defined .....	41
4.2 The different types of decision-making procedures .....	42
4.2.1 The parameters of decision-making procedures and their values .....	42
4.2.2 Four types of decision-making procedures.....	43
4.2.3 A comparison of heuristic and analytic decision-making procedures.....	44

4.2.4	Examples of the different types of decision-making procedures .....	48
Part Two: A general heuristic decision-making procedure ..... 57		
5	Overview of the decision-making procedure .....	59
5.1	The value of a general heuristic decision-making procedure .....	59
5.2	The proposed sequence of tasks .....	60
5.3	A brief explanation of the tasks .....	63
5.4	The basis of the general heuristic decision-making procedure .....	69
6	Discovering and analyzing the decision problem .....	73
6.1	Discovering the decision problem.....	73
6.2	Analyzing the decision problem.....	77
6.2.1	General considerations for problem analysis and naming.....	77
6.2.2	Establishing the decision situation.....	79
6.2.3	Determining the causes of the problem and naming the sub-problems.....	83
6.2.4	Determining the problem structure .....	88
7	Developing and evaluating options .....	91
7.1	Developing options.....	91
7.1.1	General considerations for developing options.....	91
7.1.2	Techniques for the development of options.....	95
7.2	Defining the decision criteria .....	97
7.3	Drawing up possible scenarios.....	102
7.4	The configuration of the decision problem as result of steps 3, 4 and 5.....	107
7.5	Determining the consequences of the options.....	109
8	Establishing the overall consequences of the options and making the final decision.....	115
8.1	General considerations.....	115
8.2	Overview of the decision maxims and their applicability.....	119
8.3	Decision maxims for overcoming polyvalence.....	123
8.3.1	Utility value maxim .....	123
8.3.2	The maxim of the quasi-univalent decision.....	129
8.4	Decision maxims for overcoming risk .....	130

8.4.1	Expectation value maxim.....	130
8.4.2	Utility expectation value maxim .....	131
8.4.3	Problems with the application of the decision maxims for overcoming risk .....	138
8.5	Decision maxims for overcoming uncertainty .....	138
8.6	Using decision maxims in combination to overcome polyvalence and risk or polyvalence and uncertainty .....	142
8.7	Evaluation of the decision maxims .....	146
9	A case study illustrating the application of the procedure .....	149
9.1	The situation.....	149
9.2	Discovering and analyzing the problem.....	151
9.2.1	Discovering the problem .....	151
9.2.2	Analyzing the problem .....	152
9.2.3	Summary of analysis .....	159
9.3	Developing and evaluating options.....	161
9.3.1	Developing options .....	161
9.3.2	Evaluating options .....	165
9.4	Making the decision.....	170
	Part Three: Special issues and approaches to resolving them.....	171
10	Decision sequences.....	173
10.1	What do we mean by a decision sequence? .....	173
10.2	Using decision trees to represent decision sequences .....	174
10.3	Choosing the best option in a decision sequence .....	176
10.4	Case study with a decision sequence.....	178
11	Information procurement decisions .....	185
11.1	Information procurement as a decision at the meta- level .....	185
11.2	Recommendations for decisions on information procurement .....	186
12	Collective decisions.....	197
12.1	Collective decisions and their growing importance in companies .....	197
12.2	Group goal systems and group decision behaviour.....	199
12.2.1	Group goal systems .....	199
12.2.2	Group decision behaviour.....	200
12.3	Rules for making collective decisions .....	205



12.3.1 Differing individual orders of preference as starting point.....	205
12.3.2 Requirements for forming a collective order of preference .....	206
12.3.3 Classic rules for the formation of a collective order of preference or for determining the option preferred by the collective.....	209
12.3.4 More complex procedures for the formation of the collective order of preference .....	211
Final remarks.....	219
Glossary .....	221
Index .....	229
Bibliography.....	235

## List of figures

Figure 1.1:	The different types of decision research and their dependencies.....	9
Figure 1.2:	The dimensions of decision problems and associated values.....	11
Figure 1.3:	Types of decision problems and connections between them.....	14
Figure 2.1:	Example of a goal system .....	21
Figure 2.2:	Parfitt and Collins' four indicators for a product group.....	24
Figure 2.3:	Bigler's strategic cause indicators for the monitoring of its university teaching materials.....	26
Figure 2.4:	The advantages and disadvantages of the different types of problem-finding systems and problem indicators.....	27
Figure 3.1:	Years of use and financial effects of the three options.....	32
Figure 3.2:	The net present value calculations for options B and C .....	33
Figure 3.3:	Descriptive model of the decision process .....	36
Figure 4.1:	The parameters of decision-making procedures and associated values.....	43
Figure 4.2:	Four types of decision-making procedures.....	44
Figure 4.3:	Comparison of heuristic and analytic decision-making procedures.....	45
Figure 4.4:	The three requirements for using an analytic procedure .....	47
Figure 4.5:	Development of a corporate strategy .....	49
Figure 4.6:	General Electrics and McKinsey portfolio for the Baer Group.....	50
Figure 4.7:	Data for determining optimal sales and production programmes .....	51
Figure 4.8:	Graphic procedure for optimal sales and production programmes .....	52
Figure 4.9:	Harris and Wilson's saw-tooth model of stock movements.....	53
Figure 4.10:	Costs dependent on order quantity and minimum costs in the Harris-Wilson model .....	54

Figure 5.1:	Advantages and limitations of a general heuristic decision-making procedure.....	61
Figure 5.2:	The general heuristic decision-making procedure in the basic form.....	62
Figure 5.3:	The general heuristic decision-making procedure when solving parallel or consecutive sub-problems.....	64
Figure 5.4:	The six decision types .....	68
Figure 5.5:	The basis of the general heuristic decision-making procedure .....	70
Figure 6.1:	Discovering the decision problem in the general heuristic decision-making procedure .....	74
Figure 6.2:	Problem discovery on the basis of a goal indicator.....	76
Figure 6.3:	Analyzing the decision problem in the general heuristic decision-making procedure .....	78
Figure 6.4:	Sub-steps in Step 2.....	79
Figure 6.5:	Grid for recording the chronology of events .....	80
Figure 6.6:	Customer segment - sub-market - matrix for the toothpaste market .....	81
Figure 6.7:	The development of a threat problem .....	82
Figure 6.8:	Backward-moving analysis.....	85
Figure 6.9:	The Du Pont scheme as an example of a deductive tree.....	86
Figure 6.10:	Deductive tree for the analysis of the problem of high staff turnover in a research department.....	86
Figure 6.11:	Basic forms of problem naming.....	88
Figure 6.12:	Situation of problem structuring.....	90
Figure 7.1:	Developing at least two options in the general heuristic decision-making procedure .....	92
Figure 7.2:	Solution space, solution options and optimal solution.....	93
Figure 7.3:	Effects of boundary conditions on the solution space.....	95
Figure 7.4:	Morphological analysis and the development of options.....	97
Figure 7.5:	Typical killer phrases.....	97
Figure 7.6:	Defining the decision criteria in the general heuristic decision-making procedure .....	98

Figure 7.7:	Drawing up possible scenarios in the general heuristic decision-making procedure.....	101
Figure 7.8:	Sub-steps in Step 5.....	102
Figure 7.9:	Good, average and poor winter and summer .....	106
Figure 7.10:	Example of an empty decision matrix.....	108
Figure 7.11:	The six decision types.....	109
Figure 7.12:	Central terms in decision methodology and relationships between them.....	110
Figure 7.13:	Determining the consequences of the options in the general heuristic decision-making procedure .....	111
Figure 7.14:	Temporal sequence showing the decision-making process, the decision, the implementation and the consequences.....	112
Figure 8.1:	Establishing the overall consequences of the options and making the final decision in the general heuristic decision-making procedure .....	116
Figure 8.2:	Example of a completed decision matrix.....	117
Figure 8.3:	Example of a completed decision matrix for a certain univalent decision .....	118
Figure 8.4:	The different decision maxims and their applications .....	120
Figure 8.5:	Example of a natural order in a polyvalent certain decision problem .....	122
Figure 8.6:	Example of a natural order in a polyvalent uncertain decision problem .....	123
Figure 8.7:	Example of the transformation of quantitative negative consequences into utility values .....	125
Figure 8.8:	Example of the transformation of qualitative positive consequences into utility values.....	126
Figure 8.9:	Example of the transformation of consequences with positive and negative values into utility values.....	127
Figure 8.10:	Example of the utility value maxim: starting point .....	128
Figure 8.11:	Example of the utility value maxim: calculation .....	128
Figure 8.12:	Example of expectation values.....	131
Figure 8.13:	Example of the utility expectation value maxim: starting point .....	132

Figure 8.14:	Example of the utility expectation value maxim: possible curve for the transformation of consequence values into utility values .....	133
Figure 8.15:	Example of the utility expectation value maxim: calculation of the utility expectation values .....	133
Figure 8.16:	The consequence values of the decision problem as starting point of the game .....	135
Figure 8.17:	Two different representations of the same decision problem .....	137
Figure 8.18:	Starting point for the illustration of use of the maxims for overcoming uncertainty .....	141
Figure 8.19:	Application of the minimax-risk maxim .....	142
Figure 8.20:	Decision matrix as starting point .....	143
Figure 8.21:	Decision matrix after overcoming uncertainty .....	144
Figure 8.22:	Decision matrix after overcoming polyvalence .....	145
Figure 8.23:	Example of a decision situation in which the minimax maxim should not be applied .....	146
Figure 8.24:	Evaluation of different decision maxims .....	147
Figure 9.1:	Organigram at Special Vehicles .....	150
Figure 9.2:	Cost carrier analysis .....	154
Figure 9.3:	Backward-moving analysis .....	160
Figure 9.4:	Contribution margin I for the four cost carriers of the chassis company for the year 2004 .....	162
Figure 9.5:	The five options .....	164
Figure 9.6:	The financial effects of the five options .....	167
Figure 9.7:	The effects of the five options on market position .....	168
Figure 9.8:	The completed consequence matrix .....	169
Figure 10.1:	Two examples of decision trees .....	175
Figure 10.2:	Decision tree under uncertainty .....	178
Figure 10.3:	Development of the order volume of Obelix .....	180
Figure 10.4:	The decision tree of Kessler .....	182
Figure 11.1:	Decision matrix for a product launch problem .....	188
Figure 11.2:	Decision tree with information gaps .....	190
Figure 11.3:	Calculation of the probabilities for studies advising in favour and against product launches .....	191

Figure 11.4:	Calculation of the probabilities of successful and unsuccessful product launches based on positive and negative studies .....	192
Figure 11.5:	Complete decision tree.....	193
Figure 11.6:	Procedure for making a decision about information procurement .....	194
Figure 12.1:	Parameters of collective decisions and associated values.....	198
Figure 12.2:	Goal system for an actor composed of several people .....	200
Figure 12.3:	Tendency towards poorer decisions by a group compared to an individual .....	201
Figure 12.4:	Configurations of two groups of three people ranking three options.....	208
Figure 12.5:	The configuration underlying Condorcet's voting paradox.....	211
Figure 12.6:	Individual orders of preference.....	212
Figure 12.7:	The preference patterns of the group .....	212
Figure 12.8:	The sums of the preference intensities of the 24 possible collective orders of preference .....	214
Figure 12.9:	Example of a four-level hierarchy .....	216
Figure 12.10:	The Saaty scale .....	217

## List of insets

Inset 1.1:	Descriptive decision theory, prescriptive decision theory and decision logic .....	8
Inset 2.1:	The operational cause indicators of Parfitt and Collins .....	23
Inset 2.2:	The strategic cause indicators of a publishing company .....	25
Inset 4.1:	Well-structured problems as a prerequisite for the use of analytic decision-making procedures .....	46
Inset 5.1:	Important heuristic principles and their application in the proposed general heuristic decision-making procedure .....	71
Inset 7.1:	Determining environmental scenarios as a basis for evaluating chair and ski lift projects .....	104
Inset 8.1:	Natural orders .....	121
Inset 8.2:	Transforming consequence values into utility values .....	124
Inset 8.3:	Determining utility values by means of a game .....	134
Inset 8.4:	Distorted recording of the attitude to risk through framing effects .....	136
Inset 8.5:	Determining the overall consequences in a polyvalent and uncertain decision problem .....	142
Inset 11.1:	Bayes's approach for establishing the value of additional information .....	186
Inset 12.1:	Asch's experiment on group members' pursuit of conformity .....	202
Inset 12.2:	The independence of irrelevant options as a requirement for forming a collective order of preference .....	207
Inset 12.3:	Condorcet's voting paradox .....	210
Inset 12.4:	Blin and Whinston's preference patterns .....	212
Inset 12.5:	Saaty's analytical hierarchical process .....	215

# Introduction

In today's rapidly changing environment, management personnel, whether in companies, in non-profit organizations or within governmental departments, are constantly confronted with decision problems with far-reaching consequences. Survival and long-term success will often depend on finding the right solution.

This is confirmed by research carried out in Great Britain. In the study, 270 executives were interviewed from organizations reporting a total annual revenue of more than £200,000,000 each in the three sectors "Financial services", "Central and local government" and "Manufacturing and retail". "Almost eight of ten respondents...felt organizational decisiveness had impact on overall business agility". This evaluation of the great importance of decision-making is confirmed by the fact that the average value of the financial impact of a decision is approximately £167,000 (Capgemini, 2004, p. 2).

To take the right decision is typically not a simple matter, as most decision problems are highly complex in nature. This complexity is due to a number of factors:

- The relevant goal system may not be well defined.
- The problem may have quantitative and qualitative dimensions and the relationships between these dimensions may not always be clear.
- The problem may involve more than one division or department of the company or organization.
- The problem may have a large number of possible alternative solutions.
- Future developments in the relevant environment may be uncertain.

This book focuses precisely on such complex decision problems. The aim is to provide support to management for their successful solution.

The book is divided into three parts:

- Part One provides an introduction to problem-solving methods. It first defines decision problems and then shows how such problems can be "discovered". It also discusses what is meant by rational problem-



solving. Part One ends with an overview of the various decision-making procedures.

- Part Two introduces a procedure for problem solving which is suitable for approaching any complex decision problem. We begin with an overview of the whole procedure and then examine each step in detail. Part Two concludes with a wide-ranging case study which illustrates how the suggested procedure can be used.
- Part Three looks at three special issues. The first concerns decision sequences. The second issue is the question of how to determine whether new information should be collected before taking a particular decision or whether the decision should be based on existing information. The final area is collective decision-making. The particular problems in collective decision-making are discussed and suitable approaches are put forward.

A number of well-known texts on problem-solving exist which deal predominantly with the assessment of different alternative solutions. This book goes beyond this and includes consideration of equally important issues in problem-solving: problem discovery and analysis, the development of options, and the assessment of the consequences of the different options. Mathematical approaches are not seen as central in these first steps of problem-solving: the complexity of a problem typically arises from an initial lack of transparency in its structure, and mathematical models demand well-structured problems. Such approaches can therefore only be applied once the problem has been correctly structured - which is after much of the complexity has been overcome.

This book is intended for decision-makers in companies, non-profit organizations and government agencies. It is intended as a practical working tool to help them resolve complex problems. The book will also be useful to students studying complex decision problems and is suitable as teaching material in executive courses.

To be an effective practical working tool, this book must take complexity seriously and will therefore not attempt to cloak difficulty with simplifications and a lightness of style. Working through this book will sometimes require effort, although we have tried to be as reader-friendly as possible:

- Each of the three main parts is preceded by a short introduction which sets out the content and provides an overview for the reader.
- Technical terms are explained when they are first introduced. The same terms are then used systematically; in addition, when discussing the contributions of other authors we use the terms introduced here, even if the writers themselves use a different terminology.
- We also provide a glossary with the most important terms in decision-making.
- The book has an extensive index of key terms and concepts.
- We use a large number of diagrams to support the text.
- We have included numerous examples and the whole of Chapter Nine is devoted to the application of our problem-solving procedure to a real-life problem in order to illustrate the methodological recommendations.
- We have been careful to remove from the main text those sections which, while interesting, are not absolutely necessary for the comprehension of the recommended methodology. These sections are presented as insets; those who have an interest can read them and will also find references for further reading.

We trust that these measures will help to overcome the difficulty imposed by the demands of the subject and that our recommendations in this book will prove of genuine practical use.

## **Part One: Decision problems and decision-making procedures**

Part One introduces decision-making. After working through Part One you will be able to answer the following questions:

- What is a decision problem and what types of decision problems are there?
- What are goal systems and problem discovery systems? How do they contribute to the solving of decision problems?
- What are the characteristics of a rational decision?
- What is a decision-making procedure and what types of these procedures exist?

There are four chapters:

- Chapter One introduces decision problems. First, decision problems are defined and then five basic approaches to solving such problems are presented. Of these we highlight the systematic and rational approach. The chapter ends with an overview of different types of decision problems.
- Chapter Two focuses on goal systems and problem discovery systems. The chapter begins by explaining why these systems are important in the discovery of decision problems. Next the various dimensions of goals and goal systems are presented. Finally the chapter explains problem discovery systems and the different types of such systems. A number of examples are given.
- Chapter Three looks at the characteristics of rational decisions. The chapter begins with an example, describing the course of a particular case of decision making. On the basis of this example, the chapter shows the requirements that must be fulfilled if a decision is to be regarded as rational. The final part of this chapter discusses the support that the science of management can provide to managers to help them to make rational decisions.
- Chapter Four, the last in Part One, discusses procedures for decision-making. It begins by explaining what a decision-making procedure is. The chapter then presents the different types of decision-making procedures and explains them with examples.

# 1 Decision problems

## 1.1 The decision problem

There are no decision problems in paradise! Paradise offers a happy, but aimless life. Decision problems can only emerge if a person or group of people - both referred to as "the actor" in decision methodology - develops a conscious idea of a desirable state. This state is often different from the current situation or may become different in the future. The actor is therefore required to act. He must change the current situation to the target situation or make sure that in the long term the target situation will be achieved.

The discrepancy between the current and the target situation does not in itself constitute a decision problem. A decision problem only arises if there are different ways in which the discrepancy between the situations can be overcome. The actor is then faced with the problem of devising and assessing different courses of action. It frequently happens that on first examination only one possible course of action is identified to address the discrepancy between the current and target situations. But in almost all situations there is more than one option. It is therefore better not to be satisfied with an initially identified course of action but to look systematically for options and to choose the best of them. In this way, the quality of the solution to the problem is usually significantly improved.

This means a decision problem has the following characteristics:

- A discrepancy between the current situation and the target situation.
- At least two options for action to achieve the target.

## 1.2 Ways of solving decision problems

A decision problem is present when the discrepancy between the current situation and the target situation can be reduced and/or overcome through different courses of action. There are a number of very different ways in which we can determine which course of action should be

taken. The decision can be approached:

- purely intuitively without careful reflection about the problem
- through routine recourse to procedures used in the past
- by adopting unquestioningly the solutions suggested by experts
- by choosing at random
- on the basis of a systematic rational procedure

All of the above occur in practice. They are of interest to business management researchers for the purposes of describing and explaining entrepreneurial decisions. This is known as descriptive decision theory (Gäfgen, 1974, p. 50 ff.). This book puts forward suggestions for the improvement of decision-making in practical problem situations rather than focusing on descriptions of decision processes of the past. Our book is therefore concerned with prescriptive decision theory (Gäfgen, 1974, p. 50 ff.).

**Inset 1.1** gives additional clarification of prescriptive and descriptive decision theory and compares these two approaches to a third type of decision theory - decision logic.

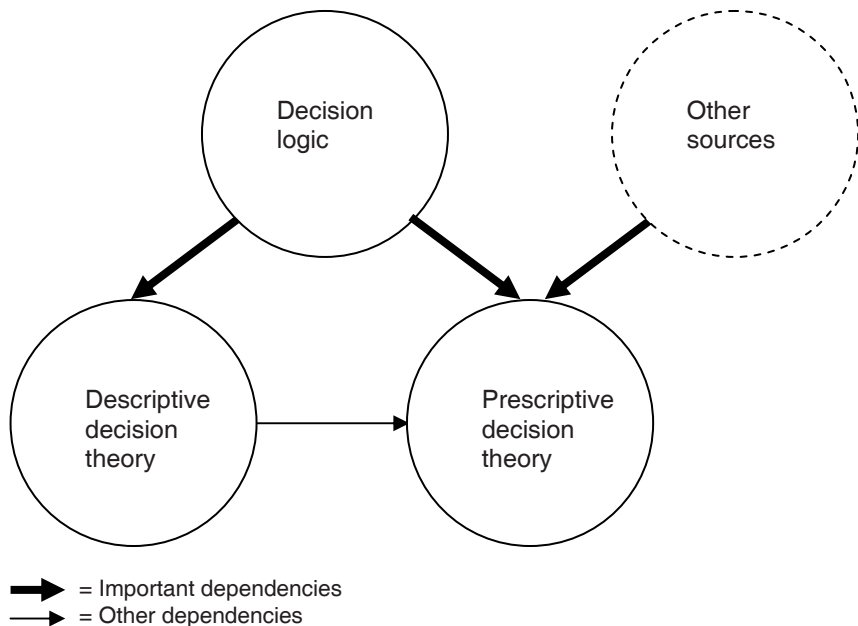
#### **Inset 1.1: Descriptive decision theory, prescriptive decision theory and decision logic**

As Gäfgen shows, models of rational choice can be developed without considering real problems. These models are only thinking experiments, logical derivations from postulated assumptions, whose results are true purely in logical terms. If standards of logic are strictly observed, there is absolute certainty that new propositions derived from given axioms are correct (Gäfgen, 1974, p. 50 f.).

One can use a model of this kind to make the implications of a given assumption clear, in our case the assumption of rational choice. From the point of view of logic, these implications are self-evident, but they are often difficult to arrive at and psychologically new. A scientist will normally only abandon an assumption once he or she understands all that is - sometimes surprisingly - implied by it. Decision models show what individual rational behaviour is like and where in everyday experience rationality and irrationality can occur. (Gäfgen, 1974, p. 1 f.)

However, in addition to showing what individual rational behaviour is like, decision logic can also serve as a basis for exploring in an empirical way how decisions are made in practice. In this case we can speak of descriptive decision theory (Gäfgen, 1974, p. 52).

Decision logic can also be used as a basis for the development of prescriptive decision models. These contain instructions for action for rational decisions and fall under the heading of prescriptive decision theory (Gäfgen, 1974, p. 52).



**Figure 1.1: The different types of decision research and their dependencies**

Decision logic undoubtedly represents an important basis for prescriptive decision methodology. But it is not the only basis for it. To develop usable decision-making procedures, a sound knowledge of heuristic principles is required (see Inset 5.1) along with practical experience of problem-solving processes. Information relevant to the development of prescriptive decision models can also be found in descriptive decision theory.

**Figure 1.1** shows the dependencies between the different types of decision research.

This book concentrates exclusively on prescriptive decision theory. Since a theory is generally understood to be an explanation of a part of reality and since prescriptive decision theory contains recommendations for shaping actions rather than explanations, the word "theory" is perhaps not ideal. Decision methodology seems a more appropriate expression.

Prescriptive decision methodology focuses on systematic rational decisions. This does not mean that the authors regard executives' intuition and experience as irrelevant. Even when proceeding rationally, incomplete information on some aspects of the situation and more particularly lack of certainty over the effects of the possible courses of action, mean that the decision-maker has to fall back on experience and intuition. If - as is often the case in practice - a decision must be made under pressure, it becomes even more important to compensate for missing information with judgements based on intuition and personal experience. Sometimes it is wise to integrate purely intuitively discovered solutions in the decision-making process and to compare them with courses of action worked out systematically. This puts the search for a solution on a wider basis. Rational action on the one hand and intuitive experience-supported action on the other should therefore not be seen as opposites; they complement each other.

### 1.3 Types of decision problems

A number of criteria can be used to distinguish between different types of decision problems (Rühli, 1988, p. 186 ff.). Below we present the criteria and characteristics to which we will return later in the book.

**Figure 1.2** gives an overview of the most important dimensions and values of decision problems.

Dimensions	Features		
(1) Degree of difficulty	Simple	Complex	
(2) Problem structure	Well-structured	Ill-structured	
(3) Problem character I	Choice Problem	Design Problem	
(4) Problem character II	Threat Problem	Opportunity Problem	
(5) Link to other decision problems	Independent Problem	Problem in a sequence of decisions	
(6) Problem level	Original Problem	Meta-problem, e.g. Information collection problem	
(7) Type of actor	Single decision-maker	Collective decision-maker	
(8) Number of goals to be followed	Single	Multiple	
(9) Ability to predict consequences	Consequences predicted with certainty	Different possible consequences with probabilities for each	Different possible consequences without probabilities

**Figure 1.2: The dimensions of decision problems and associated values**

According to the degree of difficulty of the problem (dimension 1 in Figure 1.2), we distinguish between simple and complex decision prob-



lems. A complex decision problem is present if two or more of the following conditions apply simultaneously:

- The actor pursues several objectives simultaneously. Some of them are not very precisely defined and it is possible that contradictions exist between them (In this case, it is an ill-defined problem, according to Minsky, see inset 4.1.). This situation leads to an evaluation of the problem solving options based on a larger number of criteria.
- A high number of levers of control or decision variables exist to reduce the gap between the target and the existing situation. A part of these decision variables possess many possible features. These two factors lead to a huge number of possible problem solving options (As it will be shown in chapter 7, this does not mean that the actor has to develop and assess a large number of options. In such a situation, it is recommended to develop few but very different options which cover the solution space well.).
- The future developments of several environmental variables cannot be predicted with certainty. Therefore, the actor has to evaluate his problem solving options based on several possible environmental scenarios.
- The actor possesses only limited experiences or models to determine the consequences of his options. This condition is partly, but not only, caused by the other three conditions.

If the conditions mentioned above are combined, the difficulties increase exponentially. This is especially the case for problem analysis, where the actor can no longer base himself on known experienced problem patterns. Therefore, from the author's point of view, a complex decision problem exists only when two or more of the conditions are given simultaneously. If none or only one of the conditions is fulfilled, we speak of a simple decision problem.

As the title states, this book deals with complex decision problems. The distinction between simple and complex decision problems is thus important in defining the topic of the book.

The classification into well-structured and ill-structured decision problems (dimension 2 in Figure 1.2) comes from Simon and Newell (1958, p. 4 f.). A problem can be termed well-structured if its solution can be found using an analytical decision-making process. Where this is not the case, we have an ill-structured problem. A more precise definition of well-structured and ill-structured is not possible here, as the concep-