

BOUNDED RATIONALITY IN DECISION MAKING PROCESS

The purpose of this work is to reveal the essence of the term “bounded rationality” and have a look at limitations of rational decision making process.

Economist Herbert A. Simon in the year of 1955 first proposed the idea of bounded rationality. It means a human decision-making process in which people attempt to satisfice, rather than optimize. In other words, they seek a decision that will be good enough, rather than the best possible decision. Bounded rationality is based on three main limitations that result in sub-optimal decision making. They are cognitive limitations, imperfect information and time constraint.

1. Cognitive limitation refers to our inability as humans to process all information in an optimal manner. In other words, we are unable to consider all available factors in our decision making. People today have so many choices that they have to compare hundreds of options in order to come to an optimal decision.

2. Imperfect information refers to the situation where buyers or sellers do not have all of the necessary information to make an informed decision about the price or quality of a product. The presence of imperfect information can discourage both buyers and sellers from participating in the market. Buyers may become reluctant to participate because they cannot determine the product’s quality. Sellers of high-quality or medium-quality goods may be reluctant to participate, because it is difficult to demonstrate the quality of their goods to buyers.

3. Time Constraint. When making a purchase, people often face time constraints. This might occur when they stop at the store during their lunch break or the coffee shop before work. They cannot spend half an hour in the store deciding what the most optimal lunch they should buy.

So how are decisions made?

Being aware of bounded rationality does not help people to make the best choice, because knowing about the limits of their thinking capacity, the information that is available to them, and time, does not make those limitations disappear. It also isn’t effective to try to acquire all knowledge about different alternatives when making a decision; first of all, this would take too long, and even if we had access to all the necessary information, we probably wouldn’t be able to process it.

The only way out that can help to overcome some of the limitations of bounded rationality is working in groups or teams. Working on a task together also reduces the amount of time each of them has to spend on it, meaning that they may have more time to do in-depth research about the task and expand their available information.

Let’s take an example. Mr. X is at the store to find a dessert for his wife and son. He has three options: a chocolate cake, a cheesecake, or cookies. They like them all, but

his favorite are cookies, his wife's is a chocolate cake, while his son prefers a cheesecake. Now the cookies are the cheapest, but the chocolate cake can also be saved for the next day. As we can see, there are a number of factors to consider to reach an optimal decision. Rather than spend half an hour deliberating, Mr. X just chooses the cheapest, simply based on cost.

To see how bounded rationality influences our choice in practice research was carried out. My respondents were the students of our University. They were to answer the following questions:

1. What factors are important for you when buying goods: price, manufacturer, quality, design, taste? (cognitive limitation)
2. Is the price an indicator of quality for you? (imperfect information)
3. You are in a hurry to catch a train. It will be a long trip and you haven't taken anything to eat. There is a café in front of you. How long will it take you to choose?

The results are as follows:

1. More than 90% of respondents indicated that they try to take into account all factors when buying particular goods. But as we know, it is difficult to find goods that will meet all our requirements that is why we have to choose 1-2 factors that we consider to be dominant.

2. More than 80% percent answered yes to the second question, but they also noted that they are aware of the fact that the price does not always match the quality, what is a consequence of imperfect information.

3. 100% of respondents make a choice within a minute. Provided that it is impossible to consider all the options in a minute, we cannot talk about a rational choice.

To come to a conclusion, we can see that in most cases we make choices that are satisfactory instead of making the «best» choices because of bounded rationality.

REFERENCES:

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