ERIC VAN DEN STEEN

Strategy and Strategic Decisions[1]

Strategy is a powerful tool for leading organizations to superior performance. But to be effective at this, a strategist needs to know what makes some set of choices into a strategy and what makes a particular decision strategic – and thus which decisions to focus on.

This note presents a framework to help managers and leaders do this. While the note's focus is on business unit strategy, the ideas apply more broadly to 'strategy' in other contexts.

What Makes 'a Strategy'?

A powerful way to see what a strategy is, is to look at settings where a strategy is missing. What makes you say (or complain) that 'this organization lacks a strategy'? What we typically mean is that that company's actions – while maybe sensible in isolation – do not fit together, i.e., they lack a unifying logic. An example would be a fastfood chain that promotes its low prices but then launches a burger targeted at sophisticated taste (as McDonalds did with its famous Arch Deluxe failure). Or an organization that keeps switching back and forth between different paths that are inconsistent (as HP did with its repeated repositioning of smartphones and tablets). The telltale sign of a 'lack of strategy' is thus a lack of consistency.

The role of strategy is therefore to make sure that all decisions fit together, at a point in time and over time. A strategy achieves this by specifying the core of a – appropriately flexible and adaptive – intended course of action (or plan). But strategy is *not* a detailed plan; it is a plan boiled down to its essence. It captures *just* enough of the big picture to ensure that all decisions fit together. This leads to the definition of a strategy as[a]

"the smallest set of choices to optimally guide (or force) other choices"
(towards sustained superior performance)

Before moving to a practical example, let's consider why a company's management team and its employees would need the guidance of a strategy when making decisions. Why can't everyone simply take the best decision from her perspective? The reason is twofold. First, choices interact: the optimal marketing choice depends on product development choices, and the other way around.

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[a] Note that this is a functional definition ('what does strategy do') as opposed to the more common descriptive definitions ('what does strategy look like') of strategy. Taking a functional approach makes the definition more operational and more helpful to practice. The last section discusses the relation to some other definitions.

Professor Eric Van den Steen prepared this note as the basis for class discussion.

Strategy is the set of core choices that ties together these interdependent choices, i.e., the minimum unifying thought behind an organization's pattern of actions. By understanding the company's strategy, managers and employees can anticipate what others will do and align their actions. Without a strategy, on the other hand, getting all decisions aligned would require the firm's management team and employees to get together for every decision and revisit the firm's full course of action and all relevant facts to make sure that this particular choice fits with all others. Otherwise, misalignments will quickly build. That leads to the second reason: it would not be very practical or very efficient to revisit the full set of facts and considerations for every decision or to discuss at every turn the full set of choices with the complete team. Doing so would require more time on the side of management and more expertise on the side of employees than most organizations can spare. As a consequence, without a strategy, an organization gets misaligned.

For a practical illustration of such "strategy as core guidance," consider the following strategy for Ryanair, the Irish low-cost carrier:[2]

> "offer the cheapest point-to-point short- and medium-distance flights in Europe using a low-cost model built on a frugal culture, minimal amenities, and the use of secondary airports."

As can be seen from this example, the strategic choices are high-level choices, which function as goals for lower levels in the organization and as guidance for the management team going forward. This strategy for Ryanair avoids, for example, that some of Ryanair's services would be designed to accommodate connections – raising costs – while others aren't – preventing actual connections and thus stopping Ryanair from recouping these expenses. To get the same alignment without strategy would require management and employees to revisit at every turn the question whether to accommodate connections and hence the full system design. Strategy thus enables coordination in an efficient way.

A few points in this definition of strategy deserve further clarification. First, the term "optimally" in the definition is meant to explicitly stress the need for flexibility and cost-benefit tradeoffs in how much to guide. Strategy is *not* about fixing everything in advance or guiding every choice in detail. That is exactly one way how planning and strategy differ. Second, the term "force" applies to competitive settings where strategy is often about *forcing* competitors to take certain actions that are in the company's interest. By aggressively expanding capacity, for example, a firm can force its competitors to limit theirs. This idea of forcing competitors is fundamentally the same as that of guiding employees, but now in a competitive (rather than cooperative) setting. Third, the reference to 'sustained superior performance' reflects the goal of business strategy or corporate strategy (and should be replaced by the appropriate objective for other contexts). Finally, an important class of choices that needs guidance but that is often overlooked is choices about investments in capabilities. Apple's strategy to focus relentlessly on user-friendliness gives employees clear indications what kind of know-how will be valued in the company.

A Threefold Strategy Test

As having a good and clear strategy is critical to get everything in the organization aligned towards superior performance, it is important to have a way to tell whether some set of choices is really a strategy or 'just' a set of choices. How can you check that? The following is a practical three-part test to that purpose. The test is formulated here for the case of a business unit strategy, but it can be easily adapted for other types of strategy.

Guidance ('Does it guide appropriately?') First, for each choice in the strategy, identify some reasonable and likely actions that this choice excludes and some actions that follow from it. Second, and in the other direction, pick a few decisions that are critical for the strategy's success. In other words, if these decisions don't get made correctly then the strategy is not being executed in an important way. (It is useful to look here also at choices made by someone two levels down from the CEO.) Does the strategy, as stated, make clear how these decisions should, and should not, be taken?[b] Does it make clear how these decisions should be taken differently than under an alternative or previous strategy?

Specificity ('Is it non-generic?') Pick some competitor that seems to pursue, intuitively, a different strategy. (If there is no such competitor, imagine an important alternative strategy.) Is it clear how the strategy, as developed, does not apply to this competitor?

Conciseness ('Is it really the smallest set of choices?') Could you get the same guidance in a more concise way? Is it no more than 7-10 choices? Can people remember it?

To use the test effectively, the strategist first needs to be clear on the nature of the pattern of outcomes that the company intends to get. An effective way to make this concrete is to express this in negative form: what are likely and realistic choices that would *violate* the strategy in an important way? Imagine, for example, that, a few years from now, the company will have ended up with important inconsistencies in its actions. What would be some of the major choices that caused the inconsistencies? In the case of Ryanair, the Irish low cost carrier, for example, some major deviations from its strategy would be to provide free meals or in-flight entertainment, offering connecting flights, etc. Actually, identifying the most likely and most important potential inconsistencies has benefits beyond the strategy test. First, it forces a very concrete discussion on what the strategy really is. Second, it also identifies which decision makers are most important to a successful implementation of the strategy, which is helpful to manage execution. Another effective way to get at this is to ask why exactly your organization needs a strategy, i.e., what concrete things would go wrong without a strategy. This forces you to think about where the critical interactions are.

As mentioned before, a category of decisions that is often overlooked for the guidance test, but that is very important to consider, is decisions to invest in critical capabilities, such as know-how. Strategy can be a powerful way to guide and motivate such investments, but achieving that requires some explicit attention to it.

The conciseness test implies that a strategy should be no more than a few choices and should avoid broad generalities. 'Choices' such as ‘being the preferred provider’ or ‘maximizing shareholder value’ are almost always too generic to provide guidance and should thus not be part of the strategy. To balance conciseness with clarity, it is often useful to complement the strategy with a longer, say a page-long, discussion of the ideas and their rationale. But the strategy itself should be more concise to be effective.

‘Six Elements of Strategy’ as a Rule of Thumb

Whereas the above test checks whether some set of choices is really a strategy, it is also useful – for *developing* a strategy – to have a starting point as to what choices to include in the strategy, i.e.,

[b] Note that to make clear how a decision should be taken, the decision itself does not need to be part of the strategy, as long as it can be inferred from it.

which decisions are typically strategic. To that purpose, the appendix presents the 'six elements of strategy' framework, which lays out the set of choices from which a strategy is typically selected: scope, value proposition, cost, assets, key choices, and scale.[c] The first three elements capture core choices on *where* the company will compete – its positioning – whereas the latter three are choices on *how* the company will deliver that – its business system. These six elements mirror the drivers of competitive advantage (**Exhibit 1**). Not all these elements are equally likely to be part of a strategy. In particular, whereas almost any strategy will specify scope and value proposition, the four other choices are not always included. But they are comprehensive in the sense that they cover the full set of potential choices.

This rule-of-thumb set of strategic choices is essentially a standard "smallest set of choices to optimally guide (or force) other choices" that works for the typical firm in a typical setting. As the optimal strategic choices depend on the particular setting, however, this set is just a starting point and must be customized for the particular case and application.

This definition of strategy is also helpful to use such standard set in practice. In particular, common questions such as 'do you always need to specify vertical scope?' or 'how detailed should the value proposition be?' can always be answered by: 'as necessary to optimally guide other choices'. The general definition is also a useful fallback for situations where such standard sets do not apply – such as a company's corporate or financial strategy or a health organization's strategy to deal with an epidemic – or where they apply but only after modifications – such as for not-for-profits.

What Makes a Decision Strategic?

Whereas the strategy test and the "six elements framework" are a great starting point for an overall strategy, sometimes the issue is whether a particular choice should be included in the strategy or not. To that purpose, it is important to know what general characteristics make a choice strategic. What makes 'point-to-point flights' strategic but 'be the preferred provider' not? Answering this question also gives useful insight into the nature of optimal strategy.

Whether a choice is strategic depends largely on three characteristics. In particular, a choice is more likely to be strategic when it is:

1. A central and high-level choice
2. Ex-ante ambiguous or uncertain, but with (ex-post) clear implications
3. Reliable and persistent

Central and high-level choices

Central and high-level choices are more strategic because they can guide many decisions at once, through their large number of interactions. For Wal-Mart, for example, a choice to be 'low cost' is more strategic than a choice to 'use CFL lamps in all stores' because such *high-level* choice will guide a

[c] This list is related to, and partially inspired by, David J. Collis and Michael G. Rukstad, "Can You Say What Your Strategy Is?," Harvard Business Review 86(4) (2008): 82–90. Other lists have been suggested by, for example, Kenneth R. Andrews, *The Concept of Corporate Strategy*, Homewood, IL: Dow-Jones Irwin, 1971; Joseph L. Bower, Christopher A. Bartlett, Hugo E.R. Uyterhoeven, and Richard E. Walton, Business Policy: Managing Strategic Processes, Boston: Irwin McGraw-Hill, 1995; Garth Saloner, Andrea Shepard, and Joel Podolny, Strategic Management, New York : John Wiley & Sons, 2001.

much larger number of decisions. Choice of customer scope, i.e., which customers to focus on, is almost always strategic because it is such a *central* choice. IKEA's focus on young families, for example, influences not only its product range and store services, but also its locations and marketing. A change in the choice of scope can thus reverberate through the whole business. To state this in negative terms: a decision that does not interact with any other decisions is never strategic.[d]

Strategic decisions ideally also have minimum overlap in implications. In other words, the sets of decisions that they guide should have minimal overlap – as far as possible – because overlap means either redundancy or conflict in guidance, which reduces the effectiveness of the strategy. Good strategies therefore often specify more or less one choice for each of the major business functions, such as production or marketing. But this is not always possible. High-end firms, for example, often have multiple strategic choices that pertain to the value proposition.

Ex-ante ambiguous or uncertain choices with clear implications

For a choice to be strategic, it should be non-obvious, because obvious choices are redundant. Every firm wants to 'be the preferred service provider' and wants its employees to 'leverage its resources'. Including such obvious choices in the strategy will not change any optimal choices and, hence, provides no guidance. It only adds ballast and conceals the real message. To be strategic, a decision must thus be ex-ante – before it was made and announced as part of the strategy – ambiguous or uncertain. For example, not every retailer is organic so including "organic" as part of the strategy *does* provide guidance to management and employees. It is also for that reason that making clear what the organization will *not* do can be an important part of strategy: choices what *not* to do are often non-obvious and hence can provide powerful guidance.

However, once made and announced, the choice must have clear implications. A decision to "maximally leverage our resources," for example, does not provide clear guidance as it can mean too many things.

Reliable and persistent choices

A third major criterion, and one with important implications for strategy *content*, is that decisions that are more reliable and persistent – in the sense that the eventual choice will be according to the strategy – are more strategic.

There are two reasons why reliability and persistence make a decision more strategic. Consider an airline that announces as part of its strategy a focus on families but later changes that to a focus on business executives. If employees aligned their decisions, such as amenities and marketing, on the announced "family" strategy, then all that alignment turns into misalignment once the company shifts its focus to business executives. Reliability thus improves (expected) **alignment**. Second, and more importantly, if employees expect that the company will change its strategy, then they will simply not follow the strategy and strategy loses its guiding power. Reliable decisions will therefore be more effective guides, i.e., reliability improves strategy **execution** and **implementation**, by giving employees more reason to follow the strategy.

This need for reliability and persistence has important implications for optimal strategy, in part because it constrains change and flexibility. First, it favors strategies that are built around more stable factors, such as strategies that focus on consumer needs that are unlikely to change. For example, Jeff

[d] This does not imply that the decision can't be important. But just being important does not make it part of the strategy.

Bezos' number one strategic advice is to "base your strategy on things that won't change."[3] As another example, it is remarkable how some dimensions of Apple's strategy – user-friendly products with nice designs by integrating hardware and software – has remained the same through its 40-year history. These examples also illustrate how persistence along core strategic dimensions does not preclude radical innovation, i.e., how exploration and exploitation can be combined by choosing some dimensions to explore and others to exploit. Second, in a volatile environment, strategy should be more focused around internal factors – such as capabilities or corporate culture – that are under the control of the organization and that can therefore be kept more stable, rather than around products or needs that may change quickly. This is clear in high tech industries where firms often build their strategy around their capabilities and around broad market needs, rather than around specific products or solutions. These two principles effectively allow the firm to avoid or sidestep the trade-off between flexibility and commitment. A third important implication of the need for reliability and persistence is that longer-term strategies and strategies in more volatile environments will be simpler (because there are fewer persistent decisions). Similarly, a start-up will have a simpler and more concise strategy than a mature organization.

The persistence that comes from reliable strategic choices is especially important for the development of capabilities. Almost all capabilities result from investments (in development, retention, and dissemination) that only pay off if the firm pursues a particular course of action for sufficiently long. Employees will only make these investments if they are confident about the firm's future course of action. This is a very important sense in which strategy can 'guide' decisions and choices – both choices *whether* to make such investments and choices of *which* investments to make.[e]

Strategy and Competition

In some cases, the purpose of strategy may be to force *a competitor* to make particular choices. For example, a company may rapidly expand capacity to force others to cut down on their capacity plans. Such choices are part of the firm's competitive strategy.

In such competitive setting, in order to influence the competitor's actions, the strategy must obviously be made clear to that competitor. And a modified version of the first test applies: What are the non-desired actions that this rival could take? Does the strategy make clear to the competitor that these actions will be suboptimal? Moreover, the strategy will again only be effective at influencing the competitor if it is considered reliable by the rival, i.e., if the rival believes that the firm will make good on its statements. This may require some form of commitment.

There are, however, two important caveats for this competitive use of strategy. First, when devising such a strategy, it is important to consider the risk that the rival does not 'get' the strategy in the way that it was intended or reacts differently than expected. It is thus important to assess both the

[e] There is, however, some confusion around this need for reliability. In particular, some sources have suggested that *irreversibility* is what makes a decision strategic. That is, in fact, *not* the case – at least not in the sense of `being part of the strategy': a decision's irreversibility does *not* necessarily make that decision more strategic. This is best seen through a practical illustration. Consider Tesla Motors' decision to build a specialized plant because it decides to move into mass production. The irreversible decision here is the construction of the specialized plant, whereas the decision to move into mass production is (in principle) reversible. In this case, most people would *not* consider Tesla's strategy to be "to build a specialized plant." Rather, most would say that Tesla's strategy is "to move into mass production". Letting equipment purchases – the irreversible decision – decide whether to go into mass production would put the cart before the horse. On the other hand, the need to make these irreversible investments in equipment increases the importance of strategy, to make sure that these decisions are not made by mistake. Moreover, the construction of the plant provides more commitment to the mass production strategy.

likelihood and the consequences of such different reactions. Role play may be a useful way to approach this. Second, the firm also has to be careful about anti-trust, as some strategies could be interpreted as attempts at collusion or as predatory behavior, and thus be illegal.

When is Strategy Most Important?

Not all settings benefit equally from a clear strategy. An effective strategist concentrates time and attention on those settings where strategy has most impact. This obviously requires an understanding of the conditions that make strategy particularly valuable or important.

The benefit from having a clear strategy is greatest when 3 conditions are satisfied:

1. There is a high degree of **interaction across decisions** in the sense that the benefit of making a particular choice depends on other choices. Interaction is in fact a *necessary* condition for strategy to be of value. Without interactions, each choice can be made on its own terms and there is no need for a strategy to give overall direction. This is why the idea of a 'pattern of decisions' is so important in strategy: *strategy is about creating a pattern across decisions*.[f]
2. There is **irreversibility** in the sense that some of the decisions are difficult to change. Irreversibility make it impossible for the organization to adjust and align its decisions ex-post. It therefore makes it necessary to ensure consistency up front by formulating an explicit strategy to guide (or force) irreversible decisions.[4]
3. There is considerable **uncertainty** or **ambiguity** in the sense that – prior to a strategy being announced – decision makers aren't very sure about others' decisions. Uncertainty or ambiguity makes strategy valuable because it makes it difficult to predict what others will do and thus to align with their actions (rather than because it makes it difficult to find the right decision).

With respect to interactions, strategy will be particularly valuable in settings with strong virtuous cycles across decisions, because such cycles make it important to get all decisions right.[5] With regards to uncertainty, a strategy may be valuable even when the strategist doesn't really know the optimal course of action. To say this in another way: 'strategy as a bet' can be of value. This will be the case when there is high uncertainty about the external environment combined with a high need for internal alignment. 'Strategy as a bet' then generates internal alignment by providing a focal point for coordination. High-tech firms, for example, often think of strategy as 'bets'. One important challenge with such strategic bets is to convince employees that the company will stick with that strategy, i.e., that the choice is reliable. A manager's personal conviction can sometimes provide the necessary level of commitment to this purpose.

A Note on the Literature: Relation to Other Notions of Strategy

Approaching strategy as the 'smallest set of choices to optimally guide (or force) other choices' differs from most of the management literature by focusing on the role of strategy – what strategy 'does' – rather than on descriptive characteristics – what strategy 'looks like'. It is consistent, however, with most such descriptive definitions, such as Chandler's (1969 p.13) definition as 'the determination of the basic long-term goals and objectives of an enterprise, and the adoption of

[f] Though a strategy itself can – in principle – consist of a single decision.

courses of action and the allocation of resources necessary for carrying out these goals' or Porter's (1980 p.xvi) definition as 'a broad formula for how a business is going to compete, what its goals should be, and what policies will be needed to carry out those goals.' It is also consistent with the definition of strategy by Casadesus-Masanell and Ricart[6] as a choice between different business models. Finally, it also fits the dictionary definition of strategy as 'a plan of action' (Oxford dictionary), i.e., a specification of future intended choices to achieve a specific goal. These other definitions are specific instances of 'smallest set of choices to optimally guide (or force) other choices.'

Note, finally, that this way of thinking about strategy as 'core guidance' is not limited to business unit strategy or business: it also works for a company's 'operations strategy', for its 'strategy to enter China', and for non-profits. It captures strategy as a general tool that organizations use to tackle complex problems.

Appendix: The "Six Elements of Strategy" Framework

The "six elements of strategy" framework is a good starting point for developing a company's strategy.[7] Its "six elements" are a standard set from which the "smallest set of choices to optimally guide (or force) other choices" for a typical company in a typical setting are selected. These six elements mirror the framework on the sources of competitive advantage (**Exhibit 1**).

The six elements can be usefully divided into two groups of three elements each. A first group determines the firm's positioning, i.e., the "where" of the firm, and consists of scope, value proposition, and cost. The second group determines the business system through which the firm will execute on that positioning, i.e., the "how," and consists of assets, scale, and distinctive functional and system choices. Whereas scope and value proposition are virtually always part of a company's strategy, the other elements are only sometimes strategic, but they do cover all bases and are thus a great starting point.

The three **positioning** elements are thus:

Scope Scope determines where the firm plays: 1) which *customers* the firm will serve 2) with which *products* (or services) 3) in which *geographic* markets and 4) how *vertically* integrated. It is difficult to imagine a strategy that does not specify the firm's scope along at least the customer and product dimensions. Scope is typically also a very good starting point for developing a strategy.

Value proposition The value proposition indicates how the firm's product or service performs on the most important customer criteria. It determines what distinguishes the firm's offering from those of its competitors. While this is typically the *customer* value proposition, it may include an employee or supplier value proposition. For example, part of Wal-Mart's value proposition for suppliers is access to massive up-to-date sales data. For many top consulting firms, part of the value proposition for associates is the lure of future job prospects.

Cost The cost refers to both cost level ('low cost') and cost structure ('variable cost').

The three **business system** elements are:

Key (strategic) assets These are a firm's lasting (and unique) inputs that are critical to the company's continued success. Such assets should only be included in the (explicit) strategy *if* they require employee attention to build and maintain the asset or to make sure it gets used appropriately (and such needs aren't implied by the other strategic decisions). Danaher's corporate strategy, for example, is focused on the Danaher Business System as, among other things, a stock of know-how that all its businesses should draw upon and that all should try to contribute to.

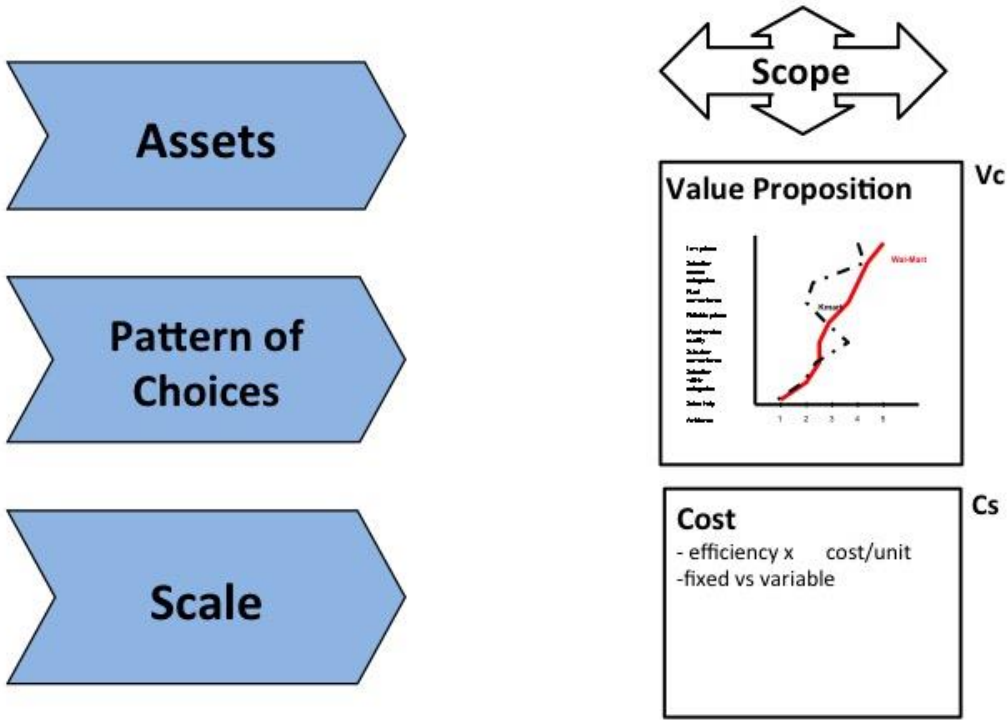
Distinctive functional and system choices These are a few high-level functional or system choices that distinguish the firm. This should focus on a few areas where the firm's approach is distinct in a way that significantly affects performance for the long term. Aldi, for example, is focused on simplicity and private-label products.

Scale (in a broad sense) Scale in a broad sense includes scale and scope (in the sense of synergies between different activities/product). If scale or scope is critical to superior performance *and* it requires specific employee attention, for example to maintain scale through aggressive defense of market share, then it should be part of the strategy. GE, for example, long had as part of its strategy that each division should be number 1 or 2 in its industry.

As discussed in other notes, these elements are related to each other and to the firm's performance (**Exhibit 1**). In particular, the business system consists of things that the firm has or does. These actions and assets then result in outcomes (over a specific scope) for customers and suppliers, in the form of a value proposition and a cost, over a specific scope. These drive, on their turn, the firm's performance.

This “six elements of strategy” framework can be used to describe the full strategic blueprint of an organization, i.e., the complete intended pattern of choices and elements to which the strategy is trying to guide. The strategy itself, however, is just a selection from that full pattern to guide the other choices and elements.

Exhibit 1 Six Elements of Strategy and the Sources of Competitive Advantage



Source: Casewriter.

Endnotes

[1] This note is largely based on the papers Eric Van den Steen, "A Formal Theory of Strategy." Harvard Business School Working Paper, No. 14-058, December 2013; and Eric Van den Steen, "Strategy and the Strategist: How it Matters Who Develops the Strategy." Harvard Business School Working Paper, No. 14-057, December 2013.

[2] Inferred by case writer from Jan Rivkin. "Dogfight over Europe: Ryanair (C)." Harvard Business School case 700-117 (2000).

[3] George Anders, "Jeff Bezos's Top 10 Leadership Lessons," Forbes.com, April 4, 2012, http://www.forbes.com/sites/georgeanders/2012/04/04/bezos-tips/, accessed March 18, 2014.

[4] In contrast to interaction, irreversibility is not a necessary condition for strategy to be of value: even unlimited ex-post adjustments may not lead to the optimal decision, due to, for example, the existence of local optima. (See Rivkin, Jan W., and Nicolaj Siggelkow. "Organizational Sticking Points on NK Landscapes." Complexity 7, no. 5 (May/June 2002)) But an increase in irreversibility definitely does increase the importance and value of strategy.

[5] This suggests some caution on how to interpret the informal finding that successful strategies tend to be very well aligned: such a high degree of alignment is often due not only to skill (developing a great strategy) but also to luck (being in an environment with virtuous circles).

[6] Ramon Casadesus-Masanell and Joan E. Ricart (2010): "From Strategy to Business Models and onto Tactics," *Long Range Planning*, 43, 195–215.

[7] The framework draws upon the Performance Analysis framework (and what that implies for sources of advantage and for competition) and upon the shorter experience-based list of strategic choices by Collis and Rukstad. See Eric Van den Steen, "Performance and Value Analysis." Harvard Business School technical note 714-490, 2014; David Collis and Michael Rukstad, 2008; David Collis and Michael Rukstad proposed that there were three components to a business unit strategy: 'objective, scope, and advantage,' with the mnemonic OSA. The 'objective' is "the single precise objective that drives the business in the next 5 years or so". The 'scope' is the same as 'scope' defined here. The 'advantage' should capture the firm's competitive advantage by specifying the company's value proposition and its unique activities. Alternative lists were suggested by Andrews, 1971, Bower et al., 1995, and Saloner et al., 2001.