What Makes Strategic Decisions Different

You have to know what kind of decision you're making in order to make it well. *by Phil Rosenzweig*

The past decade has seen a wealth of research on decision making, much of it not only useful but also fascinating to read. At the same time, a growing chorus has noted that business executives, in particular, are largely impervious to its lessons. They seem unable to apply those lessons, or perhaps uninterested in doing so. Advances in our understanding of decision making have not been matched by improvements in practice.

Having thought about this puzzle for some time, I suggest that there is a good explanation for the disconnect. It's not that executives lack the desire to make better decisions or that they're in denial about their propensity for error. The problem lies elsewhere. It's that the bulk of the decision-making research published to date applies to one type of decision, and it's not the type that's most challenging for managers. Their most important and most difficult decisions—strategic decisions with consequences for the performance of the company—call for a very different approach.

The fact is that people need to make up their minds in a great variety of circumstances, and it's a source of confusion that the same word, "decision," is used for all of them. When a grocery store customer encounters an entire aisle of breakfast cereals, we say he has a decision to make. When a high school senior considers which college to attend, we say she is facing a decision. When a poker player weighs whether to raise or fold, that's a decision, too. And when a company faces an opportunity—to enter a new market, acquire another company, or launch a new product—what is required of its management? A decision. The same term is applied to routine as well as complex deliberations, to both small-stakes bets and high-stakes commitments, and to exploratory steps as well as irreversible moves. It stands to reason that insights about decisions in one kind of circumstance might not shed

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much light on decisions in another. Even worse, they may lead a decision maker astray.

In this article I'll argue that before we can advise people on how to make better strategic decisions, we need to equip them to recognize how decisions differ. For that, we need to break the universe of decisions into a few categories. We can then suggest the best approach for each.

Let me propose a way.

Categorizing Decisions

Decisions vary along two dimensions: control and performance. The first considers how much we can influence the terms of the decision and the outcome. Are we choosing among options presented to us, or can we shape those options? Are we making a one-time judgment, unable to change what happens after the fact, or do we have some control over how things play out once we've made the decision? The second dimension addresses the way we measure success. Is our aim to do well, no matter what anyone else does, or do we need to do better than others? That is, is performance absolute or relative?

There are other ways to think about decisions, of course. Some are made by people acting as individuals and others by people acting as leaders of organizations; some are one-offs while others are part of a sequence, with the results of one letting us improve the next. But as a basic way to understand how decisions differ, control and performance are the two dimensions that matter most. Combining them creates four fields of decisions. (See the exhibit "Four Types of Decisions.")

1: Making routine choices and judgments. When you go shopping in a supermarket or a department store, you typically pick from the products before you. Those items, perhaps a jug of milk or a jar of jam, are what they are. You have no ability to improve them. Control is low. Moreover, you make the choice that suits you best—it doesn't matter what anyone else is buying. Performance is absolute. The same goes for most personal investment decisions. You may be able to decide which company's shares to buy, but you can't improve their performance after you buy them. You want high returns but aren't trying to do better than others. The goal is to do well, not to finish first in a competition.

In recent years, trailblazing research by cognitive psychologists and behavioral economists has demonstrated that people make decisions in ways that do not conform to the tenets of economic rationality. They exhibit systematic biases. Those findings have shed light on many first-field decisions in particular. For example, we now understand that the way options are framed and presented can shape our purchasing decisions. We know that investors often misunderstand the nature of random events, imagining that several gains indicate that a correction is due or that a string of losses means gains must follow—an error known as the gambler's fallacy. They also fall victim to the sunk cost fallacy, throwing good money after bad in an effort to recoup what they've lost. For many first-field decisions, research has taught us to be aware of and try to minimize these common biases.

2: Influencing outcomes. Many decisions involve more than selecting among options we cannot improve or making judgments about things we cannot influence. In so much of life, we use our energy and talents to make things happen. Imagine that the task at hand is to determine how long we will need to complete a project. That's a judgment we can control; indeed, it's up to us to get the project done. Here, positive thinking matters. By believing we can do well, perhaps even holding a level of confidence that is by some definitions a bit excessive, we can often improve performance. Optimism isn't useful in picking stocks whose performance we cannot change, but in the second field, where we have the ability to influence outcomes, it can be very important.

Some activities call for us to move between the first and second fields, shifting our mind-set back and forth. The approach known as "deliberate practice," which can lead to expert performance (see "The Making of an Expert," by K. Anders Ericsson, Michael J. Prietula, and Edward T. Cokely, HBR July–August 2007), is based on objective and deliberate thinking before an event, full commitment with a

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Idea in Brief

THE PROBLEM
Research has revealed much about how to improve decisions, yet managers make little use of the insights.

THE IDEA
The fact is, the decisions we make fall into four different categories. The right approach depends on how much control the decision maker has over terms and outcomes, and on whether success will be judged in relative or absolute terms.

THE ADVICE
Managers will make better strategic decisions when they learn to identify which kind they're facing and develop the versatility to change approaches accordingly.

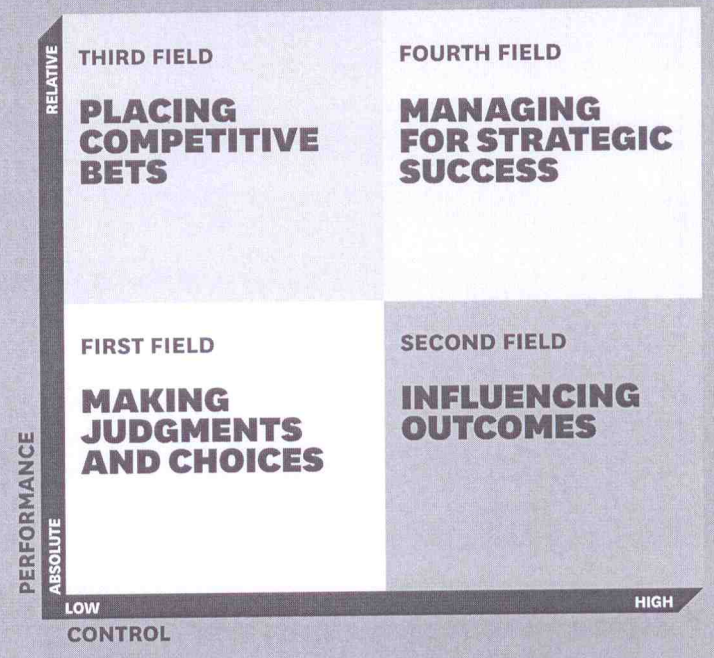
positive attitude while taking action, and then a return to dispassionate analysis after the event—what is known as an after-action review. The ability to shift effectively between mind-sets is a crucial element of high performance in many repeated tasks of short duration, from sports to sales.

3: Placing competitive bets. The third field introduces a competitive dimension. Success is no longer a matter of absolute performance but depends on how well you do relative to others. The best decisions must anticipate the moves of rivals. That's the essence of strategic thinking, which Princeton professor Avinash Dixit and Yale professor Barry Nalebuff define as "the art of outdoing an adversary, knowing that the adversary is trying to do the same to you." Investments in stocks are typically first-field decisions, but if you're taking part in a contest where the investor with the highest return takes the prize, you're in the third field. Now you need to make decisions with an eye to what your rivals will do, anticipating their likely moves so that you can have the best chance of winning.

In the third field, guidance comes from the branch of economics that studies competitive dynamics: game theory. Well-known illustrations of game theory include the prisoner's dilemma and the game rock-paper-scissors, in which the winner is determined by the interaction of all players' decisions. Game theory can illuminate areas from price competition to geopolitics, yet it has an important limitation: Players cannot alter the terms of the game. The possible moves are specified, and gains and costs cannot be changed. That's a helpful simplification for purposes of modeling, but it reduces the value for managers. Management, after all, is precisely about influencing outcomes over time. That's why Herbert Simon, in his 1978 Nobel Prize address, commented that for all its sophistication, game theory does not provide "satisfactory descriptions of actual human

Four Types of Decisions

To get better at making decisions, it's important to recognize the different types. Those in the first field of the matrix—where we have no control over outcomes and our performance is absolute (we aren't competing with anyone)—include consumer choices and personal investment decisions. Those in the fourth field—where we can influence outcomes and need to outperform rivals—include the strategic decisions that are most challenging for managers, such as launching a new product or entering a new market.



First-Field Research, Fourth-Field Decisions

In many of the most consequential decisions executives face—whether to acquire a company, say, or launch a new product—they can influence the outcomes, and their choices are successful only if they're better than the competition's.

These decisions fall into the fourth field of a matrix that categorizes decisions along two dimensions: our control over the outcome and whether the outcome depends on other people's decisions. We would benefit greatly from improving how we make these fourth-field decisions. Yet most recent research has examined judgment and choice in first-field decisions, which offer no control over outcomes and can be successful regardless of what anyone else does.

This focus stems in part from the power of carefully controlled experiments, which are an ideal way to isolate the cognitive mechanisms of human thought. By asking subjects to make choices among clearly stated options or to make judgments about things they cannot influence, we derive responses that can be neatly com-

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behavior." An essential aspect of so many crucial decisions is absent.

Decisions in the Fourth Field

The crux of our discussion comes into focus when we consider the fourth field. For these decisions, we can actively influence outcomes, and success means doing better than rivals. Here we find the essence of strategic management.

Business executives aren't like shoppers picking a product or investors choosing a stock, simply making a choice that leads to one outcome or another. By the way they lead and communicate, and through their ability to inspire and encourage, executives can influence outcomes. That's the definition of "management." Moreover, they are in charge of organizations that compete vigorously with others; doing better than rivals is vital. That's where strategy comes in.

The decisions to enter a new market, release a new product, or acquire another firm are all in the fourth field, but we can find many examples beyond business. In sports, a coach shapes the performance of athletes, melding them into an effective team that can outperform the opponent. Or think of politics. For a voter, casting a ballot is essentially a first-field decision: You vote for the candidate you prefer. For the candidate, however, the reality is very different. Election day is the last hurdle in a long process in which performance is relative—only one person can win—and outcomes can and must be shaped. Candidates need to inspire donors, build an organization, attract and motivate campaign workers, and ultimately persuade voters. A winning political campaign depends on a smart assessment of rivals as well as the ability to mobilize supporters, often in the face of long odds.

The fourth field includes some of the most consequential decisions of all, but because of their complexity they don't lend themselves to the careful controls of laboratory experiments, so we know less about how best to make them. (See the sidebar "First-Field Research, Fourth-Field Decisions.") What sort of mind-set do they require? When we can influence outcomes, it is useful to summon high levels of self-belief. And when we need to outperform rivals, such elevated levels are not just useful but indeed essential. Only those who are able to muster a degree of commitment and determination that is by some definitions excessive will be in a position to win. That's not to say that wildly optimistic thinking will predictably lead to success. It won't. But in tough competitive situations where positive thinking can influence outcomes, only those who are willing to go beyond what seems reasonable will succeed.

In recent years a great deal of attention has focused on teaching executives to be aware of common biases and to avoid their ill effects. (See "Before You Make That Big Decision..." by Daniel Kahneman, Dan Lovallo, and Olivier Sibony, HBR June 2011.) Of course it's good to appreciate the lessons of cognitive psychology and to understand the propensity for common errors. But if we apply those lessons to the

pared, free of extraneous factors. Decision research has made profound contributions because of the rigor of its experimental methods.

The unintentional effect, however, is that less research has focused on the second and third fields, and much less on the fourth field, where the ability to influence outcomes makes the comparison of responses across people problematic, and where the need to outperform rivals adds further complexity. Thus the paradox: Fourth-field decisions, which in real life include many of the most important, have received the least attention.

Decision experiments have certainly improved our understanding of the human mind, with many practical applications. The danger lies in taking the findings that are appropriate for one kind of decision and applying them to other kinds. We should not be surprised if business executives seem not to embrace this advice. Strategic decisions are fundamentally different from the routine choices and judgments so elegantly captured in laboratory settings. To do justice to the decisions executives face, researchers should employ a wider range of methods.

world of strategic management, we're missing a trick. When facing decisions in the fourth field, executives need on the one hand a talent for careful and dispassionate analysis, which we call left-brain thinking, and on the other hand a willingness to push boundaries, which we call the right stuff.

Discernment and Versatility

In the course of their daily responsibilities, executives face a range of decisions, often in each of the four fields outlined here. Before making any decision, the most important thing is to understand which field it is in. For routine judgments and choices, where we cannot influence outcomes and need not consider the competition, well-known lessons about avoiding common biases make good sense. For other decisions, a different set of skills is needed.

In his profile of St. Louis Cardinals manager Tony La Russa, Buzz Bissinger wrote that baseball managers require "the combination of skills essential to the trade: part tactician, part psychologist, part riverboat gambler." That's a good description of many kinds of decision makers, in business as well as in sports. The tactician plays a competitive game—sensing the actions of rivals, anticipating the way a given move may lead to a countermove, and planning the best response. The psychologist must shape outcomes by inspiring others, by setting goals and providing encouragement, and by offering clear and direct feedback. The riverboat gambler knows that outcomes aren't just a matter of cold numbers and probabilities; it's also important to read an opponent in order to know when to raise the stakes, when to bluff, and when to fold.

Decision makers need to develop two vital skills. First, they must be able to discern the nature of the decision at hand. Second, they need to respond with the appropriate approach, able to act now as a psychologist, then as a tactician, next as a riverboat gambler, and perhaps once again as a psychologist. When it comes to the most complex decisions of all, those that drive the fortunes of organizations, executives need more than an ability to avoid common errors. They require a seemingly contradictory blend: a talent for clear-eyed analysis and the ability to take bold action. ▽ **HBR Reprint** R1311F


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"What's the advancement program here other than waiting for someone to die?"

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