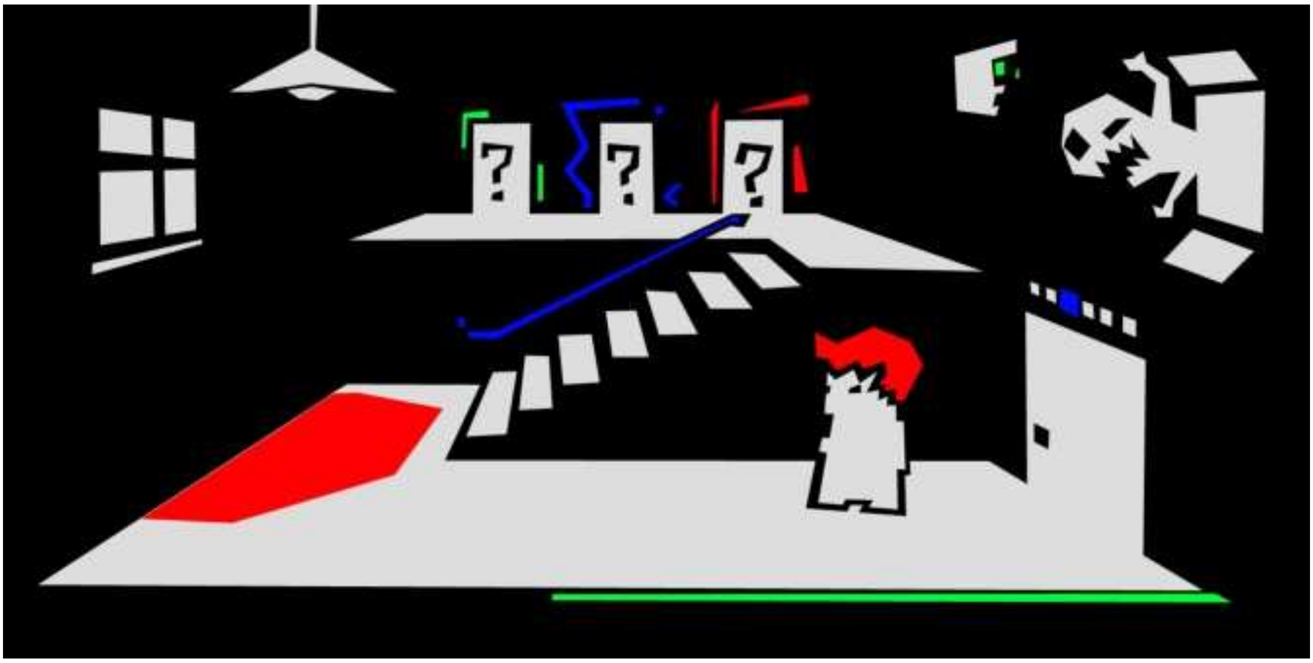
Smart and simple strategy decisions to minimise regret

Why we should not try to pick the best option, but instead use simple rules to eliminate the worst choices - by Verena Stingl, Joana Geraldi and Josef Oehmen



We like to think that for our strategy work, we will have plenty of time and resources. Armed with both, out of the 10s or 100s of options we have on the table, we will pick the best one.

In this article, we will make the opposite argument. Not only do we not have much time or resources available to make decisions, we also should NOT try to pick the best option. Instead, we should use simple rules – quick and easy decision-making shortcuts – to eliminate the worst options.

When we think about seizing strategic opportunities, we tend to picture brilliant one-in-a-million ideas. However, most of the decisions that truly realise strategy have only little of that entrepreneurial glamour. They tend to be questions of balancing uncertainties: Should we accept a contract of a difficult client in a desirable market? Should we partner with that organisation with unique technology but weak finances? Should we hire that manager who has a reputation of ‘turning the shop around’ but also of being somewhat of a wildcard?

To make things worse, many of our strategy decisions and implementation actions take place in a heavily constrained environment: the chance to seize the opportunities is usually limited in time and by what our competitors do. Moreover, any opportunity is fundamentally uncertain and ambiguous – we think the market will respond favourably, but maybe it won’t.

In short, picking the “best” option is practically impossible. So what now?

We studied executives to figure out how they make decisions of strategic importance when business reality does not let them have the time or quality of information they want. The short answer is: instead of trying to maximise value, they will aim to minimise regret. In plain English, instead of looking for the best option, they make sure to eliminate the worst ones.This is not necessarily all that new. Michael Porter argued quite some time ago that strategy is about deciding what *not* to do. So, how can we do that quickly and reliably?

We investigated an extreme case of this, competitive bidding for engineering contracts, and extracted some general lessons for strategy decisions. A competitive bidding process has many similarities with making strategic choices. There are a limited number of options, each one has advantages (say, conquering a giant market) and disadvantages (say, it's technically risky). And both are usually afflicted with significant uncertainty.

Just like success, regret will ultimately be measured in financial terms. The bottom line of minimising regret is to minimise your maximum possible loss. But on the way there, it can take many forms: wasting resources on an idea that ultimately did not come to fruition; exposure to safety or reputation risks; or non-compliance or other legal risks. Regret can also be an opportunity cost, for example watching a competitor commercialise a product idea you dismissed two years ago.

When we observed the executives we studies, we found that they used three sets of criteria to eliminate options: 1. clear, 2. ambiguous, and 3. combinatory criteria. Let's look at each of them individually.

1. *Clear knock-out criteria*

Clear criteria almost exclusively relate to boundaries set explicitly or implicitly in the strategy or other communications of the organisation, so having a clear strategy actually does help! They focus on aspects that have one unambiguous answer, such as: do not pursue strategic opportunities with unlimited financial liability; or that are located in countries outside of strategic target markets; or that do not clearly align with our technical core expertise. While establishing and following these rules seems easy enough, in practice they require careful fine-tuning in order not to sacrifice your innovation potential for an uninspired business-as-usual approach.

This brings us to the second set of criteria: Dealing with strategic opportunities that are attractive and risky at the same time:

2. *Ambiguous knock-out criteria*

Most decisions did not have the luxury of being clear-cut yes/no choices along one dimension. Take for example the following six criteria that were shared by practically all of the executives involved in competitive bidding. Typically, a single "no" to any of them would typically lead to the rejection of the opportunity:

- Is there a fair chance to beat the competition in bidding?
- Do we want to work with the client?
- Do we have time enough to develop a solid tender?
- Is the project in a location where we can and want to deliver?
- Do we have the capabilities to deliver the main share of what is required?
- Is the contract acceptable?

All of those criteria are ambiguous – although a yes/no answer on the surface, it is obvious how different people could come to different conclusions for each of them. For example, for one executive, the chance to beat the competition may rely mainly on the number of competitors – for another it relates to the geographical distribution of the competition.

For ambiguous criteria, it is thus significantly more complex – but also more important – to formulate clear rules within a team as to what qualifies for a "yes" and what for a "no" answer. What we discovered as critical here were two aspects: First, making sure we identify and ask all the important questions; second, build a shared understanding of the various context factors that influence the decision.

3. *Combinatory knock-out criteria*

Finally, several of the knock-out rules we found considered multiple, typically two or three, criteria together. These rules were used later in the process, after the opportunity field had already been screened by the first two types of criteria. These types of decisions required more time and information, and were thus only applied later.

They would for example evaluate the technical requirements of a suggested project against the capabilities of their available resources, and figure in factors such as resource re-allocation or outsourcing of certain elements to external partners.

Making simple rules work

Paraphrasing Watzlawick, we can't not simplify our decision-making. The key is to make conscious choices, create a shared understanding in your organisation of what are relevant criteria and context factors, and finding your personal sweet spot of decision making speed versus decision making quality.

What you can do is to help the decision-makers in your organisation figuring out the simple rules that really work to minimise regret on your strategic journey. In other words, help them say No to the right (or rather: "strategically wrong") things. Start by asking the following four questions:

- What are our "big regrets"? When has a strategy truly failed?
- What are our big strategy risks? What are the fewest risks we can consider without considering too few?
- What can we decide based on formal rules, and what needs discussion? What needs data, and where do we trust our intuition?
- What decision rules worked for us and why? What changed and what rules are no longer working for us?

♣♣♣

Notes:

- *This is the fourth in a series of five articles based on research carried out at the engineering systems division of the Technical University of Denmark (DTU) and supported by Brightline Initiative.*
- *The post gives the views of its author(s), not the position of the institutions they represent, the LSE Business Review or the London School of Economics.*
- *Featured image credit: Image by 2014 Lunar Eclipse. Public domain under CC0.*
- *When you leave a comment, you're agreeing to our Comment Policy.*

Verena Stingl is a PhD fellow at the Technical University of Denmark (DTU), engineering

systems division. Her research interests concern human cognition and behaviour in highly uncertain business environments, such as project and portfolio management.

Joana Geraldi is an associate professor at the Technical University of Denmark (DTU), engineering systems division, as well as at Copenhagen Business School (CBS), department of organisation. She studies human and organisational behaviour in projects and develop behaviour-centric organisational contexts for projects.

Josef Oehmen is an associate professor at the Technical University of Denmark (DTU), engineering systems division. His research interests focus on managing large-scale (systems) engineering programs, particularly on the application of risk management, lean management and the associated organisational strategy processes.

October 19th, 2018 | Management, Strategy series | 0 Comments