

Strategy as Diligence: PUTTING BEHAVIORAL STRATEGY INTO PRACTICE

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SUMMARY

Researchers in behavioral strategy are producing new insights on strategic decision making. At the same time, a few pioneering companies are discovering ways to put behavioral strategy into practice. This article draws on behavioral research and strategy practice to present an approach called diligence-based strategy. In markets comprised of people rather than rational economic agents, the analysis of competitive advantages matters less than the diligent execution of fundamental activities. Diligence-based strategy offers an applied method for formulating and executing strategy in organizations, showing how managers can leverage technology and management discipline to drive business success in the twenty-first century.

KEYWORDS: diligence, behavioral strategy, strategy process, strategic management, strategic planning, decision making

In 2014, Concha y Toro UK (CyT)—an importer-distributor of wines made in Chile, Argentina, and California—faced a crisis in competitive strategy. Global distributors with established brands were moving aggressively into the U.K. market, smaller entrants were experimenting with new business models, and downstream consolidators were shifting the balance of power to a few large corporate retailers. Confronted with the threat of eroding market share, declining profit margins, and an aging business model, CyT executives knew something had to change.

But CyT did not follow the conventional path for managing large-scale strategic change. Executives did not articulate a crisis or launch a strategic audit of market trends or competitive threats, and the company made no attempt to revolutionize its market strategy or business model. Instead, executives turned their attention to a small number of ordinary business activities such as procuring

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inputs, managing customer relationships, and developing people. Then, leveraging stakeholder relationships, Internet technologies, and social media, the company commissioned a new system for monitoring capabilities in fundamental activities for CyT and its competitors. From this platform, executives developed improved systems for goal-setting, measurement, and allocating resources to the everyday fundamentals of business success.

This renewed commitment to mastering and executing the fundamentals of business success—supported by empirical data, Internet technologies, and new analytical methods—transformed strategy making at CyT. By deliberately shifting management attention from the traditional abstractions of “big strategy” to the daily realities of fundamental business practice, CyT executives generated a powerful body of longitudinal data for sensing market shifts, tracking competitive activity, setting priorities for investment, and defining new strategic initiatives. According to one CyT executive, the shift was “a complete game-changer. Without question, it revolutionized the way we think about strategy.”

Competitive and technological conditions in the twenty-first century are changing the way companies conduct their strategy processes. The pace of competition requires executives to strategize and act at the same time, to bring Internet technologies into the strategy process, and to focus on a few highly leveraged activities that drive business outcomes. In these conditions, some executives find that the traditional building blocks of business strategy—analyzing industries, choosing the scale and scope of the firm, positioning for competitive advantage, and seeking differentiated resources and capabilities—have outlived their usefulness. The strategic shift now underway at CyT—and in larger consumer companies such as PepsiCo and Mars—heralds the arrival of something genuinely new, a significant movement that transcends the particulars of any method or technique. It may indeed signal a landmark shift in the attitudes of top executives toward the practice of strategic management.¹

The magnitude of the signal is faint, but its outlines are clear. Executives no longer believe in sustainable competitive advantage as a concept. They have little patience for impressive platitudes or drawn-out strategy talk. They attend relentlessly to what they can control, while rejecting the notion that strategy and operational excellence, or strategy formation and execution, are separable things. They rely more on measurement and evidence, and less on opinions and persuasion. They view strategy as a continuous process involving decisions and actions, not as a periodic process involving only decisions. They value not only hard data and quantification but also organization culture, which they construe as shared meaning and disciplined performance management. They challenge firm boundaries by embracing open organization, user communities, and social media. Learning through trial and error, executives are carving out a novel set of strategy principles founded on data, communication technology, and the relentless measurement and control of the fundamental activities that determine business success.

In developing this approach, managers have paid less attention to academics and consultants than to practitioners in other competitive domains. For example, one source for diligence-based strategy is the “moneyball” phenomenon, in

which baseball executive Billy Beane used advanced statistics and activity monitoring to overthrow traditional methods of evaluating baseball talent.² In the past decade, these techniques have spread through business, sports, and other domains. In professional golf, PGA and LPGA touring pros keep a close eye on GPS-enabled competitive statistics for driving distance, driving accuracy, and average distance from the pin, and on technology-enabled swing statistics for clubhead speed, spin rate, and launch angle.³ Young golfers attend premium academies in Florida, Arizona, and Dubai, and they study with world-class coaches, nutritionists, fitness instructors, and psychologists. These players maximize performance by applying the new power of technology, statistics, and sports science to the mastery of fundamental activities that have always determined success in golf: driving, iron play, hazard play, putting, and the mental game.

Companies like CyT bring this approach to business competition by focusing on the fundamental activities that drive success in any business: activities such as developing new products, building stakeholder relationships, managing supply chains, serving customers, and managing culture. This approach is “diligence-based” because it values data, measurement, and behavioral perseverance above large-scale strategic ambitions such as industry transformation and sustained competitive advantage. It is “strategy” because it permeates every aspect of organizational strategy, from goal-setting and strategy formation through resource allocation and day-to-day execution.

The principles of diligence-based strategy provide a method for putting these ideas into practice. This article draws theoretical inspiration from cognitive psychology and behavioral research, while rejecting the rationality and efficiency assumptions that entered the theory and practice of strategic management through economics. Assuming that markets are composed of human beings rather than rational economic agents, diligence-based strategy shows the consequences of bringing realistic assumptions about human behavior to the practice of strategic management.

The Chess Syndrome

As practiced by large companies and taught in business schools, strategic management is largely an art or science of the intellect. Corporations and strategy consultancies employ sophisticated analytical tools for understanding markets and internal resources, and MBA students learn general theories and techniques for industry analysis, competitive positioning, and the internal analysis of the firm. The tools of strategic analysis are widely disseminated and embedded in the strategy processes of companies.

In using these tools, strategists are vulnerable to a state of mind that might be called the “chess syndrome”: the belief that the purpose of strategy is to analyze and choose strategic moves. Through training and experience, business strategists learn to assess industry structures, recognize patterns in industry and competitive trends, evaluate a company’s competitive position, develop and evaluate strategic options, judge probabilities and payoffs of future events, and choose the scale,

scope, and competitive position of the firm. Because these tasks are cognitive and analytical, they suggest parallels between business strategy and other domains in which competitive positioning plays an essential role—most notably chess, in which the analysis of competitive moves is paramount.⁴

The problem is that chess and business are very different games. Chess grandmasters such as Magnus Carlsen and Garry Kasparov have extraordinary gifts for recognizing patterns and seeing deeply into potential lines of play. However, these mental gifts constitute *the whole game of chess*. Choosing a good chess move is intellectually complex but behaviorally trivial: when a decision is made, the player reaches across the board and moves the piece to a new square. Implementation is swift and unproblematic, and unexpected events never get in the way. Chess players never think about strategy execution because chess strategies never fall apart between thinking and doing.

Ease of execution distinguishes chess from domains of human activity that require both thinking and doing, such as mountain climbing. In the past 60 years, mountain climbers have discovered 18 different routes up Mount Everest. Most of these routes have been tried more than once, and every experienced climber knows which ones offer the greatest probability of success. As it happens, 99% of climbers choose the Southeast Ridge from Nepal or the North Ridge from Tibet. Statistics show that the Southeast Ridge yields slightly higher success rates and fewer deaths, but taking weather and other factors into account, many climbers prefer the North Ridge and the success rate there is reasonably high.

Unlike chessmasters, climbers of Mount Everest must consider strategy execution, both during the climb and while planning the climb. In chess, there are 24 possible moves at the opening and 10.9 million possible positions by the seventh move. In climbing Everest, there are only two feasible moves at the start and movement is continuous and effortful. The two feasible paths up the mountain are widely known, and climbers do not agonize over the choice of paths. Indeed, most climbers choose their paths implicitly before deciding whether to go on the expedition at all, knowing that the decision entails *equifinality of choice* (climbers can reach the top on either path), *randomness* (which may hinder or assist the climb), and *continuous interaction with external forces* (such as weather, Sherpas, equipment, and other climbers).⁵

These characteristics radically alter the strategy process from beginning to end. Success in climbing Everest does not depend on choosing the right path but on the climber's capacity to deal with the conditions of the actual climb. Climbers still have to make choices, but the critical choices do not involve the analysis of paths. They involve mastering the fundamentals of mountain climbing, assembling and managing the right team of people, and anticipating and dealing with the conditions of the climb.

Diligence-based strategy assumes that business strategy is not contemplative like chess, but expeditionary like going up Everest. Problems in business strategy are characterized by equifinality, randomness, and continuous interaction

with external forces. In business competition, the range of strategic options is always constrained by external conditions and past choices, and executives seldom face a large number of feasible paths; in many cases, the actual number of feasible paths is one.⁶ In business strategy, good decisions sometimes fail, bad decisions succeed, margins for error are large, and the conditions of implementation can erase or reverse the core assumptions on which positioning decisions were based. Companies do not fail every time an executive chooses the wrong path, and it often happens that the human and economic conditions of competition—poor implementation of a bad decision, poor decisions by competitors, a favorable demand shift, a lucky change in government regulation, a corporate takeover—allow executives to profit from their own mistakes.⁷

This does not mean that business strategists should never think about competitive moves, or should avoid strategy tools like decision analysis or scenario analysis. But they should recognize that analyzing and choosing competitive moves do not determine a company's success or failure, any more than choosing a good exercise program determines a person's level of fitness.⁸ Almost any fitness program will get results if a person actually does the work, and no fitness program will get results if they do not. When implementation is hard, success depends less on chess-like mental virtuosity than on Everest-like diligence in executing a small number of fundamental activities that are familiar to everyone who plays the game. In allocating scarce top management attention, strategy executives should remember that firm performance does not come from clever choices but from relentless attention to the fundamental drivers of business success.

Behavioral Foundations

Theories and concepts in strategic management bear the strong imprint of microeconomic theory.⁹ Strategy theories share with economics the assumption that a company cannot beat its rivals by adopting widely available practices that are known to improve business performance. Strategy theories assume that homogeneous companies perform homogeneously, so a company cannot win by imitating its competitors. It can try to do the same things better, but “strategy is not operational excellence.”¹⁰ If a company adopts a profit-making practice, its rivals—which are rational, observant, and open to new ideas—will copy the practice and the market will return to the zero-profit equilibrium. The only way a company can gain a performance edge is by building sustainable competitive advantages protected by barriers to imitation.

These kinds of assumptions are useful to economists studying prices and outputs in market competition. However, they are not empirical truths about actual markets comprised of human beings. We know, for example, that neither individuals nor groups conform to the assumptions of rational actor theory, that people imitate bad practices as well as good ones, and that companies neither observe nor imitate each other in the ways assumed by economic theory.¹¹

Empirical evidence shows that companies often fail to copy the observable best practices of other companies. The literature is vast, but a few examples indicate the direction of the evidence.¹² For example, Salter found that copper mining companies took as long as 20 years to adopt widely available cost-saving rail technologies, and Johnston found that management consultants produced efficiency gains as high as 200% by helping their clients install boilerplate management control systems. Primeaux showed that the adoption of cost-efficient technologies varied substantially among large electric utility providers, and Kamberoglou and colleagues, in a study of Greek banks, found large differences in the adoption of fundamental management practices. In a field experiment of Indian textile producers, Bloom and colleagues offered free consulting services and found that the adoption of basic business practices—quality control, inventory management, and HR processes—produced large gains in productivity and profitability compared with a control group; and in a sample of more than 700 companies in the United States, the United Kingdom, France, and Germany, Bloom and Van Reenen found large variations in fundamental management practices, reporting a “long tail of badly managed firms” with “surprisingly bad management practices.”

According to conventional theories, these disparities in basic management practices should not occur. A company should not beat the competition by performing commodity-like activities that can be performed by anyone in the market. Companies are not supposed to leave money on the ground or find it there.¹³ If this happened even to a moderate degree, competitive markets would be inefficient and unpredictable. A company with competitive advantages might go out of business by failing to implement “hygiene” activities, or a company without competitive advantages might beat the competition by diligently implementing ordinary activities. Such outcomes would contradict widely held beliefs about strategic management theory and practice.

More realistic assumptions about market behavior can be found in the emerging literature on behavioral strategy. According to Powell, Lovallo, and Fox, behavioral strategy “aims to strengthen the empirical integrity and practical usefulness of strategy theory by grounding strategic management in realistic assumptions about human cognition, emotion, and social interaction.”¹⁴ Drawing insights from cognitive and social psychology, behavioral strategy challenges the behavioral assumptions of microeconomic theory by treating market efficiency and decision rationality as empirical questions to be observed and tested in the actual behavior of market participants.¹⁵

Behavioral research shows that human market participants do not behave like rational economic agents. Real people are in many ways more impressive than economic agents. They are capable of passion, benevolence, insight, and perseverance. They have moral and aesthetic ideals, and they exhibit altruism, trust, reciprocity, compassion, justice, loyalty, and love. As in the *Moneyball* story, people in organizations make seemingly absurd creative leaps that can transform an enterprise and alter the dynamics of market competition.

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