The Biggest Blunders in Sports

... and tips from research about how to avoid them
Trying to understand the science behind strategy

By Chana R. Schoenberger

Where do brilliant decisions come from? Business schools teach entrepreneurs and aspiring executives to be successful—training them to make brilliant decisions and hire people who do the same. But while graduates may leave with improved strategic skills, researchers have only recently begun collecting the empirical evidence to explain how lessons learned in the business-school classroom produce effective decision-making in the field.

James E. Schrager, clinical professor of entrepreneurship and strategic management at Chicago Booth, is working to prove empirically that there’s a method behind good strategy. He knows that strategy can be learned—a conclusion he has arrived at after 30 years spent teaching people how to make smart decisions—but decades of anecdotal evidence in the form of student success isn’t enough. Schrager wants scientific proof, which he is in the process of gathering. “It’s a dream for strategy to have more empirical research,” he says.

Schrager is a pioneer in a nascent field. He recalls one morning in 2009, while working to collect his thoughts for a paper, he woke up and scribbled on his bedside notepad the phrase “behavioral strategy,” a term he had never heard, but which seemed to synthesize his methods. Other researchers were having similar thoughts. Now researchers worldwide—from Columbia University to Oxford to Australia’s University of New South Wales—are further studying, through the lens of strategy, how people make decisions that change their businesses.

The idea that economists should study how humans make decisions rather than rely solely on theoretical notions goes back to the work of the late Herbert Simon. Simon, who received his undergraduate degree in 1936 and later a PhD in political science in 1943, both from the University of Chicago, won the 1978 Nobel Memorial Prize in Economic Sciences for his work on decision-making. He pioneered the concept of bounded rationality, the notion that a person’s ability to make rational decisions is limited by time and information, among other factors.

Behavioral economics, the field Simon’s research launched, involves “ignoring parts of economic theory and replacing it with careful observations of what people actually do,” Schrager explains. Next came behavioral finance, the study of how people make investing decisions, which builds further on Simon’s findings.

A few months after Schrager struck upon the term, a leading strategy publication, the Strategic Management Journal, announced a special issue about the idea of behavioral strategy as a new field. The topic was so popular, Schrager says, that the editors received some 120 submissions, four times the normal amount.

Good strategy begins with good questions

The field of strategy is traditionally taught through stories and questions, which provide the foundation for learning. Students learn to make decisions by analyzing case studies to determine what executives have done well, or badly. Typically this involves synthesizing the facts and working through a set of questions.

Booth’s New Venture Strategy course asks students: Is starting this particular business a good idea? To answer that, and to evaluate any new business, students learn how to ask the right questions, drawing on the facts in front of them and their own knowledge to arrive at answers. Questions lead to decisions, which Schrager and other behavioral strategists consider “the heart” of strategy.

While case studies accomplish pedagogical goals, Schrager and other behavioral strategists want to identify the science behind what makes case studies work. They believe that business decision-makers use an underlying framework, which allows them to make sense of data, much in the way people use patterns to solve puzzles.

Simon famously observed this technique in chess players. In chess, grandmasters are skilled at pattern recognition, mentally processing patterns from past games as they look for the best ways to move their pieces on the board. That’s what separates out the best players. Schrager wonders, “How does a great chess player sort to find the important patterns and throw out the 9,999,990 that don’t matter?”
Simon’s insight, one he applied to economics, is that the best chess players ask a set of questions—the same questions for every similar situation—and use their answers to determine a game plan. Inspired by Simon, Schrager is proposing to use a set of questions to help business executives select the right pattern when making strategic decisions. These questions make up what Simon calls a representation, a list of key issues enumerating what really matters in a complex problem. According to Schrager, the representation is the determining factor in whether a strategy problem can be solved: “It’s obvious, but unless you see [the questions] you have no idea where to start,” he says.

In chess, for instance, the representation that leads to winning games includes questions such as, “Is my king safe?” and, “Who controls the center of the board?” The questions and answers change as the game proceeds. A grandmaster understands which questions to ask, and when. Simon’s research finds that is key to being able to win.

A pilot strategizes through a crisis in the air by working through a mental list of questions drawn from his experience flying in order to narrow down the possible choices: “Can I maintain altitude? Can I control the aircraft?” These questions are his representation, which make sense of a problem so he can recognize the patterns and find a solution. Firefighters do the same in an emergency, as do nurses.

The idea can be generalized to apply to any strategic choice, says Schrager. Consider the decision to buy a car. “You are not going
looking at two thousand different cars. You will pick a small number through representation: 'I want a small car, reliable, with good resale value.' Having narrowed down the choices from the universe of cars to just those that meet your criteria, you can choose among a reasonable number of options.

The best strategists develop these representations over time, Schrager says, each representation tailored to a specific set of situations, such as how to expand a business internationally, or when to close a struggling unit, or how to hire a senior manager.

Studying representations

H. Edward Wrapp, a former professor of business policy at Chicago Booth who died in 2010, published an article in 1967 that is still valued by strategy analysts today, in which he observes that top executives tend to ask perceptive questions rather than give direct orders. But the question that fascinates Schrager is: How do executives arrive at those perceptive questions?

To an outsider, it’s not clear that there’s a systematic process in place, but the process can be observed. Schrager learned this while working for the billionaire Pritzker family, the Chicago-based owners of Hyatt Hotels Corporation and myriad other companies. Schrager spent from 1981 to 1990 working for the Pritzkers in various executive roles, turning around companies throughout the family’s empire. Any time the Pritzkers wanted to purchase, revamp, close, or sell a business, Schrager was able to see how they approached strategic decisions.

“They would ask fabulous questions,” says Schrager, but the questions varied, and he initially had no idea how they came up with them. By scrutinizing the questions over time, he figured out what patterns the Pritzker patriarchs, Jay and Robert, were seeing. A breakthrough came for Schrager one day, after watching executives give presentations about possible deals. He theorized that the strategy for each new venture included a unique set of questions that probed into the business. Similar ventures were probed using similar sets of questions.

Cracking this code was good for Schrager’s assignments: it meant he could anticipate the questions the Pritzkers would direct at him about businesses that he was running—and better provide answers. He also took these lessons back to the classroom, where he tested and further confirmed his theories on case studies used in class. Confident that representations were key to theory, he began using them to help his students understand how business leaders thought about the problems they faced.

Schrager left the Pritzkers armed with an understanding of representations, eager to test it elsewhere to see if companies could adopt the concept to form their own successful strategies—to develop the ability to tell a good idea from a bad one, before the bad one is implemented.

In 2009, Schrager joined the advisory board of Performance Trust Capital Partners LLC, a Chicago-based broker-dealer that manages $1 billion in fixed-income assets for middle-market financial institutions. A partner and Booth alumnus Jason Elder suggested Schrager to the CEO, Richard Berg.

To help the company understand its strategy, Berg agreed to do a postmortem of his CEO years thus far to examine the major decisions he had made. “We looked at the things that did well and things that failed,” Berg says.

Schrager believed that Performance Trust executives had been asking the wrong questions. So he led a project that introduced a corporate-strategy representation that executives could use to analyze decisions, and to identify patterns that would predict a failure before it happened.

Schrager believes the set of simple questions, one of which required the firm to define its competitive advantage, helped focus the CEO’s mind and allowed strategy decisions to move beyond intuition. (He can’t disclose the exact questions, concerned that doing so might affect his current research.)

The company used Schrager’s questions while the board was considering an acquisition. The representation forced Berg, who was in favor of the acquisition, to take another look at the data in a methodical way. Berg changed his opinion, and the board instead asked the target company for certain parameters to complete the deal. When the conditions were not met, Performance Trust passed on the acquisition. “In hindsight, it was a brilliant decision,” Berg says. “All too often, I learned, we are asking the wrong questions. That was very revealing to me.”
Formalizing the knowledge

Ever since Simon introduced the idea of behavioral studies in business, some economists and finance academics have grounded their research in the observation of decision-makers in action. But Simon never wrote a paper applying his theories to strategy, nor did a formal examination of Simon's ideas exist anywhere in the strategy literature. Schrager proposed such an examination in a paper, co-authored with Albert Madansky, H.G.B. Alexander Emeritus Professor of Business Administration at Chicago Booth, published last year in the Journal of Strategy and Management.

Schrager and Madansky argue that many strategists use a representation, often unconsciously and without understanding the method they are using, to solve a problem. The pair have been outlining this idea at a series of informal meetings with researchers who study organizational behavior, behavioral science, and teaching. They have encountered skeptics. "For the behavioral science people who had studied under Simon, they all said, "What's new?" They all knew these ideas, but had never seen them applied to strategy," Madansky recalls.

To convince doubters, the behavioral strategists need data that show quantitatively how strategists create a representation that they use to solve the problems at hand. To gather that information, Schrager and Madansky have been conducting experiments for the past two years, and have examined the behavior of 256 students so far. Broadly, the experiments test how people make decisions, and how people's understanding of representations relates to their ability to choose the right path. The researchers are reluctant to disclose much more because the experiments are ongoing, and the methods and findings are being refined. But they are now testing this concept with Booth MBAs and alumni to measure the difference a representation can make in and out of the classroom.

The researchers want to prove that Simon's ideas work for strategy decisions. They then hope to identify how to apply these ideas to specific businesses. As the goal of behavioral strategy is to understand how decision-makers arrive at conclusions, a distilled version of these theories could help businesses executives understand the representations that govern their own industries in order to make better decisions.

"We don't have enough science yet," Schrager says, expressing confidence that will change as the field continues to develop.

Works cited

