HBR.ORG
Harvard Business Review
MARCH 2016
REPRINT R1603E

SPOTLIGHT ON ENTREPRENEURSHIP FOR THE LONG TERM

# Lean Strategy

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***by David Collis***

# SPOTLIGHT

**ARTWORK**
**Margaret Neill, *Stream*,** 2008
Acrylic on canvas

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# Lean Strategy

***Start-ups need both agility and direction.***

*BY DAVID COLLIS*

Strategy and entrepreneurship are often viewed as polar opposites. Strategy is seen as the pursuit of a clearly defined path—one systematically identified in advance—through a carefully chosen set of activities. Entrepreneurship is seen as the epitome of opportunism—requiring ventures to pivot in new directions continually, as information comes in and markets shift rapidly. Yet the two desperately need each other. Strategy without entrepreneurship is central planning. Entrepreneurship without strategy leads to chaos.

What many entrepreneurs fail to grasp is that rather than suppressing entrepreneurial behavior, effective strategy encourages it—by identifying the bounds within which innovation and experimentation should take place. But executives who want their established firms to be more entrepreneurial often don't fully appreciate how stage-gate processes, multiple-horizon planning, and other corporate tools for managing strategic growth initiatives can undermine innovation.

The reality is, integrating the bottom-up approach of lean start-ups with the top-down orientation of strategic management remains devilishly hard. Is there a way to get the best of both worlds?

Yes. The solution is something I call a *lean strategy process,* which guards against the extremes of both rigid planning and unrestrained experimentation.

It emerged from the more than 20 years I've spent studying and working with entrepreneurial ventures and large companies. In this framework, strategy provides overall direction and alignment. It serves as both a screen that novel ideas must pass and a yardstick for evaluating the success of experiments with them. Strategy allows—indeed, encourages—frontline employees to be creative, while ensuring that they remain on the same page with the rest of the organization and pursue only worthwhile opportunities.

## The Entrepreneur's Challenge

Howard H. Stevenson of Harvard Business School defines entrepreneurship as "the pursuit of opportunity without regard to resources currently controlled." This highlights the fundamental challenge confronting entrepreneurs: They all suffer from a shortage of money, talent, intellectual property, access to distribution, and so on. While acquiring additional external resources is partly the answer, the internal challenge is to wisely shepherd, conserve, and deploy the resources the venture does possess. That is exactly what strategy is all about. Indeed, the single best piece of advice for any company builder is this: Know what *not* to do. Strategy helps you figure that out.

Much more so than leaders of established firms, entrepreneurs need to recognize these fundamental principles:

**The opportunity cost of doing A is that you cannot also do B.** In a resource-constrained venture, choices are mutually exclusive. If you allocate two software engineers to customize a product for a new customer, you will delay the release of version 2.0 of the product by three months. No amount of experimentation will get around this problem.

**Every choice creates a unique path with a different outcome and unforeseen implications.** This is why you cannot simply do A now and B later—because circumstances will almost certainly have changed. Competitors will have launched their own version 2.0. Key suppliers will have signed contracts that commit all their capacity to others. Potential customers' judgments about the service will already be clouded by their experience with a competitor's version. The employee who would have been instrumental in pursuing B will have left the company. Every choice is an irrevocable rejection of something else.

**The single best piece of advice for any entrepreneur is this: Know what *not* to do.**

**Decisions are interdependent.** If John in marketing does A, it has ramifications for Peter in product development, and vice versa. Any venture needs to ensure that the scarcest resource—people's time—is spent on the tasks that are critical to the organization as a whole, not just to one department. In an established firm, operating units are subject to many organizational constraints: the brand's positioning, a shared sales force, and so on. Those constraints help ensure consistency among initiatives and innovations. A new venture, however, lacks organizational parameters; the world is its oyster. This makes it even more important for entrepreneurs to set boundaries.

**Simple market tests aren't always useful.** The lean start-up camp celebrates agility and adaptation through rapid testing. That may be an effective way to innovate incrementally and fine-tune an offering's fit with the market, but some ideas simply cannot be evaluated in a series of quick, cheap experiments. Though few concepts require all-or-nothing investments, as the launch of Federal Express did, many do entail substantial up-front expenditures. Innovations that bring to market truly novel products and services, like steel minimills and electric cars, often involve building complete ecosystems and require long-term investments.

While adoption rates are accelerating (Facebook achieved 100 million users in just over four years, WhatsApp in two years), some businesses will mature more slowly. Customers may need time to appreciate the value of a new product, or suppliers may need to work down a cost or experience curve to deliver at a reasonable price. Businesses such as accountable care organizations in health care and Tesla's lithium ion batteries would never have gotten off the ground had they been expected to demonstrate immediate success.

What's more, quick A/B tests that capture customer preferences may fail to account for various

## Idea in Brief

**THE ISSUE**
Leaders of start-ups often see strategy, the pursuit of a clearly defined path that is systematically identified in advance, as the enemy of entrepreneurship, which requires ventures to be opportunistic and quickly shift course as they learn what customers want.

**THE REALITY**
Entrepreneurs badly need strategies that articulate what their ventures will and will not do. Such boundaries are crucial for making the most of scarce resources, deciding which ideas to pursue, and evaluating experiments. But a rigid, fixed strategy is dangerous.

**THE SOLUTION**
The lean strategy process integrates the bottom-up approach of the lean start-up with the top-down orientation of strategic management. In an iterative fashion, the venture builds new capabilities and revises the original strategy in response to what it learns.

alternatives' longer-run impact on brand reputation and purchasing behavior. Such tests also focus too heavily on initial usage. Sometimes immediate traction with target customers is ephemeral: Users tire of the novelty or—like Groupon's customers—find that repeated use is uneconomical. This is one reason that consumer-packaged-goods firms are careful to distinguish trial from repeated use.

### How Strategy Can Help

In a world governed by the principles discussed here, a strategy that articulates the firm's overall direction is indispensable. It helps entrepreneurs do four things:

**Choose a viable opportunity.** Rigorous strategic analysis can distinguish markets that promise enduring success from those that offer only the illusion of substantial, if immediate, returns. Many a new firm has failed because it pursued the latter. The archetypal example is a business with low barriers to entry. Consider Groupon again. Its innovative model of online coupons for local retailers and service providers quickly generated sales. Unfortunately, anyone and her mother could also launch such a site—and did. Demand for the service proved transitory, and no one has made any money in the business.

Yes, an entrepreneur can make a quick killing by starting such a business and then selling it to a strategic (or foolish) buyer. A classic example is Minnetonka. It brought to market a series of innovations—from Softsoap to the pump dispenser for toothpaste—that had no protection from copycats. Yet as the first mover, the company could grow rapidly before selling out to established firms: Colgate-Palmolive bought its soft-soap business, and Unilever bought the other product lines. However, this business model still reflects a strategic choice: Knowing that the business cannot be sustainable, the entrepreneur does everything possible to minimize long-term commitments and maximize the gross margin and sales while looking for the exit.

Another misstep is entering a large and growing market without analyzing whether the firm will be able to build a sustainable competitive advantage in it. Best Buy, Mattel's line of Barbie dolls, eBay, and a slew of others entered China thinking that anyone could make money there—only to fail. It may be much wiser to pursue several smaller, less risky opportunities that together could create a successful long-term business.

An initial strategic screen can save a venture from going down the wrong path: one that might be readily validated by a market test of a minimum viable product but is unlikely to support a long-term business. At Eleet, a start-up based in Providence, Rhode Island, the founders (one of whom is my son) initially developed eight possible B2B and B2C use cases for their concept, providing chauffeurs to drive you in your own car. For a few hundred thousand dollars, the team could have rapidly tested some of those use cases. But before trying out even one, the founders analyzed the target markets and recognized that a B2B version would be the most sustainable. As a result, they set aside the B2C use cases and instead ran tests that demonstrated the existence of high-volume B2B users, firms that would provide the service to their employees in lieu of limousine service. They're now in the early stages of trying to build that business. (Full disclosure: I've advised, invested in, or served as a board director for Eleet and several other companies mentioned in this article.)

**Stay focused on the prize.** Ventures that lack strategic bounds try to do too much and spread themselves too thin. Because they fail to concentrate their available resources, they can't win in any key market.

Sophia Amoruso, founder of Nasty Gal, initially succeeded in building a business that resold vintage clothing on eBay. Then she diversified into a variety of new activities: selling brand-name designer clothing; a magazine; an autobiography (*#GirlBoss*) and promotional book tour; retail stores; international websites; and branded products such as shoes, swimwear, lingerie, and home goods. Seduced by an overabundance of opportunities, she threw a lot of ideas against the wall to see what would stick. But with no clear focus, employees stumbled over one another, competing for resources—including Amoruso's attention—and growth stalled. She stepped down as CEO in January 2015.

In a similar manner, new ventures—driven by the need to generate cash to meet payroll—often respond to every sales inquiry, even when the customer is not in the target set. In its start-up phase, Picis, a health-care information-systems company, was pursuing two markets, operating rooms and intensive care units, winning orders in both. But in both markets the firm was struggling to get traction. After it decided to concentrate on operating rooms (and made a related acquisition), it was able to gain share and build a viable position.

**Align the entire organization.** In tiny start-ups, it may be possible to coordinate activities through daily personal interaction. In larger ventures, project management or a bureaucracy can help somewhat with this, but only a strategy allows a leader to empower all employees while avoiding duplicative efforts and the pursuit of conflicting agendas. A clearly articulated strategy can ensure that every aspect of an organization—the type of personnel hired, the compensation system and reward metrics employed, the IT system installed, and so on—is designed to support its distinctive value proposition.

A clarified strategy prevented staff members at Muzzy Lane Software, an educational gaming company, from continuing to pursue work-for-hire that produced one-off games. This had been an important source of funding: A single contract could cover the company's cash burn for several months. But the firm realized that its real focus should be on educational publishers, and having built a core software platform on which such firms could develop their own content, it needed to improve the suite of authoring tools. Diverting developers to customize a game would slow down that critical activity. The staff was actively discouraged from seeking such projects.

**Make the necessary commitments.** After deciding which opportunities to pursue, firms must make the investments needed for success. Obviously, testing should be done to minimize risk and maximize the value of each one. But, as discussed earlier, every so often an investment, like building a hospital in a new district, has to be made without a guarantee of return or the ability to be tested in phases. In those cases, it's critical to conduct a careful analysis before proceeding. And, of course, the investment must be a strategic fit.

## Combining Deliberate and Emergent Strategy

If strategy is to address the entrepreneur's challenge, it must also embrace entrepreneurial techniques. Entrepreneurship—empowered local experimentation—allows a firm to explore the right innovations and continually refine them to better fit the market. It's necessary no matter what a firm's size or industry is. Here's how to incorporate it effectively into strategic approaches:

**Vision.** The lean strategy process begins with perhaps the only aspect of the strategy that should in any sense be permanent: the organization's vision or ultimate purpose—the reason for its existence. A vision should be compelling and motivational. It may also be aspirational and possibly even unachievable. Microsoft's original vision, for example, was to place "a personal computer on every desk." Under its founders, Ben & Jerry's strove to "make the world's best ice cream, to pursue progressive social change, and to provide fair compensation to employees and shareholders alike."

**Deliberate strategy.** To deliver on the entrepreneurial vision, a deliberate strategy should be agreed upon by senior executives. It should be crafted with involvement throughout the organization, from a rigorous evaluation of the firm's current strengths and weaknesses, internal resources and capabilities, and external opportunities and threats. The deliberate strategy will identify the broad market position where the firm can use its unique capabilities to satisfy customer needs in a way that no competitor can.

In my view, the three underlying elements of a strategy are objective, scope, and competitive advantage. (Though I won't go into the details here, you can find them in my April 2008 HBR article with Michael Rukstad, "Can You Say What Your Strategy Is?") Let's look briefly at how those three concepts apply to new ventures.

**FURTHER READING**

Want to improve your firm's innovation track record? If so, you'll find many useful lessons in these HBR articles:

**"Cisco's CEO on Staying Ahead of Technology Shifts"**
John Chambers

**"The Discipline of Business Experimentation"**
Stefan Thomke and Jim Manzi

**"Why the Lean Start-Up Changes Everything"**
Steve Blank

**"Figure It Out"**
Beth Comstock

**"Looking to Join the Lean Start-Up Movement?"**
Scott Anthony

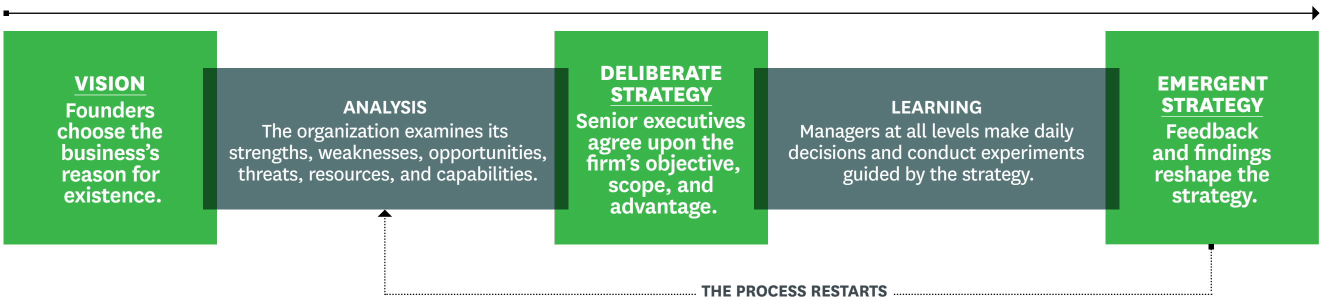
**"Failing by Design"**
Rita McGrath

**"Strategies for Learning from Failure"**
Amy C. Edmondson

**"The Value Captor's Process: Getting the Most Out of Your New Business Ventures"**
Rita McGrath and Thomas Keil

## THE LEAN STRATEGY PROCESS

By combining traditional strategy with lean start-up practices, ventures can align employees around a common purpose, make the most of limited resources, learn from the market, and then adjust the strategy.




**Objective.** This is an articulation of the near-term goal that defines success in the eye of the venture's leader. If her objective is to go public within three years, that will have implications very different from those of building a sustainable business she'll still control five years out, or of selling to a strategic buyer once the business is established. For each objective, the strategy must also establish the metrics that will maximize the firm's market value when achieved. With an IPO, for instance, the metrics might include X million new customers, a Y% share of online retail, version 3.0 installed at Z key customers, and so on.

**Scope.** Probably the most critical strategic guide rail, scope identifies "what business we are in" and draws boundaries around what the venture will and will not do. Southwest, for instance, developed its original low-cost-airline strategy within a clearly defined domain. It decided not to compete head-to-head with the majors in big airports or on routes with flight times over a couple of hours. Instead, Southwest concentrated on building a dominant network of short-haul flights between second-tier airports. And since another premise of the strategy was that low prices had to be simple and transparent, the airline devoted no efforts to complex yield-management initiatives that would have allowed Southwest to wring the maximum fares from passengers.

**Competitive advantage.** Any venture needs clarity about how it will win—why customers will buy its products rather than those of competitors. That advantage should help the company satisfy an underlying customer need and, ideally, address an immediate customer pain point. It can be captured in a summary of features that are superior to those of competitors, which may also acknowledge, if not even celebrate, those aspects of the product or service that will underperform. This distinctive value proposition should align the firm's activities and shape future experiments.

One of Southwest's key advantages, for example, was rapid turnaround time, which helped it maximize its use of assets and keep prices low. The airline chose not to provide meals, because doing so would have increased costs and turnaround times. When passengers complained, customer service personnel merely responded with polite letters explaining that adding meal service would raise fares.

**Emergent strategy.** In implementing the strategy, managers at all levels in the organization make myriad decisions every day. The sum of all these independent choices gradually alters the company's position and determines the exact form the strategy takes over time. This is the emergent dimension of strategy.

Many frontline decisions, like daily flight departure times at Southwest, are routinized and require little or no thought. Some, like whether to hold a plane at the gate to accommodate delayed connecting passengers, require judgment and should be informed by the company's strategy. And some are conscious variations that seek to improve an existing product or practice. One incremental innovation suggested by Southwest employees, Business Select, gave passengers a free drink and early boarding for a small premium. Because it would not interfere with fast gate turns, the airline introduced it.

It is here that the notion of strategy as a filter looms large. In considering what experiments to undertake, people throughout an organization develop and test hypotheses about how to improve the strategic positioning by identifying current mismatches, gaps, or opportunities in the offering's fit with the market. Thus entrepreneurial activity in the lower levels of the organization is not random. For instance, rather than developing complex yield-management software algorithms, as other airlines did, Southwest's IT group focused on innovations in customer self-service that could be delivered on low-cost, personal-computer-based systems. Similarly, frontline personnel came up with Southwest's boarding procedures (the unique numbered stands for boarding at a Southwest gate), which contributed to the carrier's rapid turnaround time.

Once an innovation is introduced, the strategic screen again comes into play. The venture now has to evaluate the outcome of the experiment and decide whether to end, continue, or amend it (a decision that will have lasting repercussions). Without a broader orientation, wrong conclusions can be drawn from results. During the Battle of Britain, for instance, after-action reports built a picture of where damage had been inflicted by the Nazis on Spitfires returning to base. This was used to identify the areas on the planes that needed to be reinforced—that is, until a bright spark pointed out that they were not the areas that were most vulnerable. In all likelihood, the areas where there was no damage on returning planes were most problematic, since hits there meant planes never came back.

**A firm evolves as the result of incremental choices made every day.**

Strategy provides a framework for interpreting market feedback. It is only with a clear strategic perspective that organizations effectively learn from experiments. If the outcome of the innovation is simply a no-go decision, all the information and skills that were developed through it will be lost. But if the firm carefully digs down into where things went right or wrong—which hypotheses were validated or disproved—it can amend the strategy wisely. Instagram's original strategy was to develop a private mobile phone app, Burbn, that "enabled friends to check in to locations, make plans (future check-ins), earn points for hanging out with friends, post pictures, and much more." When users reacted negatively to an app that could do all those things, the baby was not thrown out with the bathwater. Instead, the founders decided to focus on being really good at one thing. Noticing that users posted a lot of pictures, they spent eight weeks developing a better photo-sharing app and doing a beta test. The rest, as they say, is history.

In response to environmental changes and the findings of experiments, the venture builds new internal capabilities and, if necessary, revises the original deliberate strategy. Then the process begins all over again. It is therefore true that the firm evolves as a result of the incremental choices made every day. However, this does not imply that the strategy emerges only after the fact. Rather, at every point in time there has to be clear agreement on the constraints imposed by the current strategy, even if that strategy does shift.

Nuventive, an ed-tech company, had a suite of products for assessing and improving institutional and student performance. But with limited revenue, it had to choose to invest in a focused way. As it turned out, the company's focus would change over the years as market opportunities waxed and waned, and the relative attractiveness of product lines shifted. Nevertheless, at each point in time, the strategy made clear to everyone in the firm which products had priority and which innovative ideas would have first dibs on scarce resources (the software developers). The other products were just provided enough support to keep them viable. Nuventive was, therefore, flexible enough to adjust to the changing marketplace but strategic enough to deliver against the best opportunity.

**STRATEGY MATTERS** even more to entrepreneurs than to established businesses. Yet lean methods for innovation also have a lot of value. The two are not in conflict; rather their reconciliation in the lean strategy process holds out hope for entrepreneurs in organizations of all sizes to become agile, effective innovators.

Any resource-constrained organization needs a strategy that defines boundaries. Clarifying what is in and what is out of bounds ensures that experimentation is not rampant and is encouraged within those parameters. It helps firms identify the long-term attractiveness of possible business models or market spaces before testing their feasibility. By combining strategy and experimentation in such a fashion, all firms can greatly increase the odds of achieving lasting success.

**HBR Reprint** R1603E