M2L19. Escalation of Commitment in Business

Slide #1

In this topic, we will discuss escalation of commitment in business.

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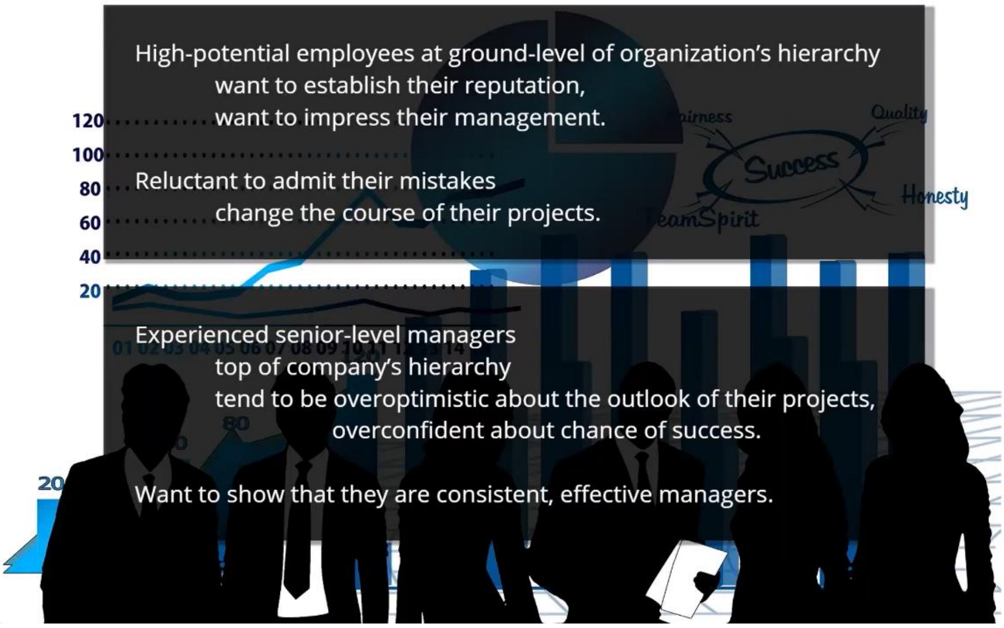

Escalation of commitment is common among employees across different levels of organizations.

High potential employees at the ground level of an organization's hierarchy want to establish their reputation and impress their management.

Those ground level people are reluctant to admit their mistakes and change the course of their projects.

At the same time, those experienced senior level managers at the top of a company's hierarchy tend to be over optimistic about the outlook of their projects and overconfident about the chance of success.

They exhibit an escalation of commitment to the projects they have started.

They also want to show that they are consistent, effective managers.

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There are many signs in a business where you can tell that escalation of commitment occurs.

For example, some projects have been underperforming for a while.

The sales were lower than expected, and the quality of the product did not meet customers expectations.

However, their project managers keep saying that we are simply experiencing the downside of project problems that we know can occur.

They refuse to cancel the project or significantly change the course of the project.

To continue investing resources in the problematic project is a common escalation of commitment bias in an organization.

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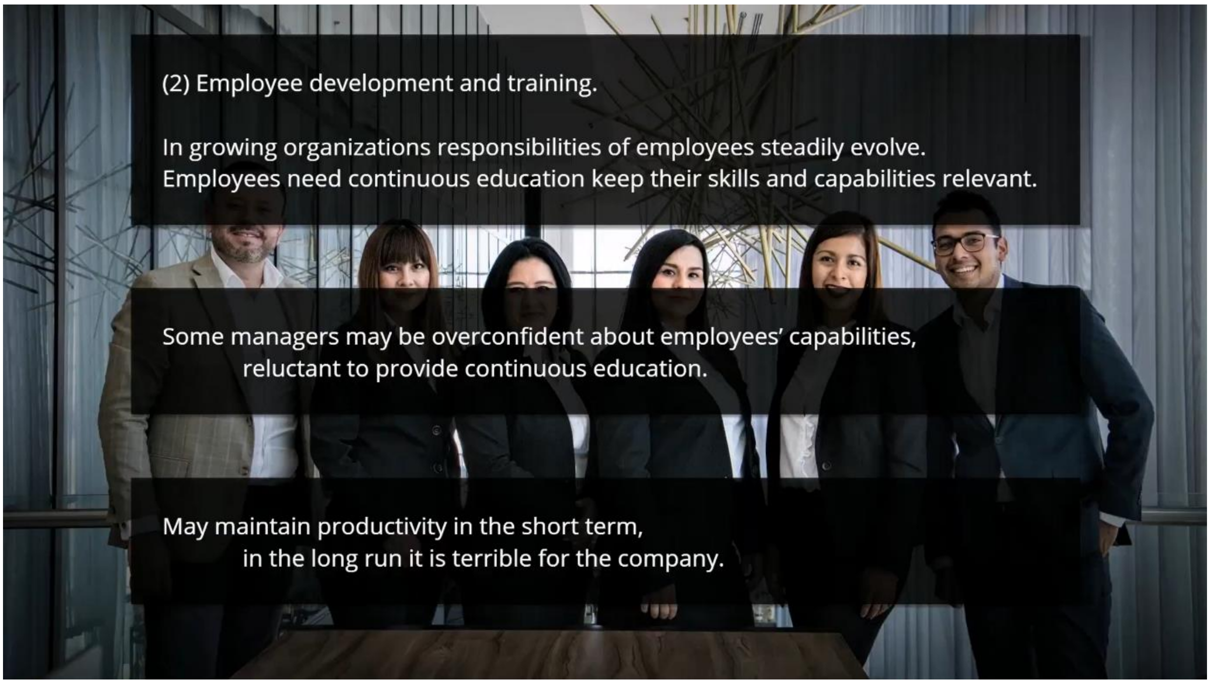

The second common sign of escalation of commitment in the organization is in employee development and training.

In growing organizations, the responsibilities of their employees steadily evolve, so their employees need continuous education to keep their skills and capabilities relevant to their responsibilities.

Some managers may be overconfident about their employees' capabilities and are reluctant to provide continuous education to their employees.

They tend to make subjective arguments in reference to the critical feedback from other managers about their employee's capabilities.

One example of the defensive response is my employees are better than yours.

These managers' decisions not to invest in their employees may maintain the productivity of their employees for the short term, but in the long run, it is terrible for the company.

Eventually, the company will run out of talent and the capabilities to grow its business.

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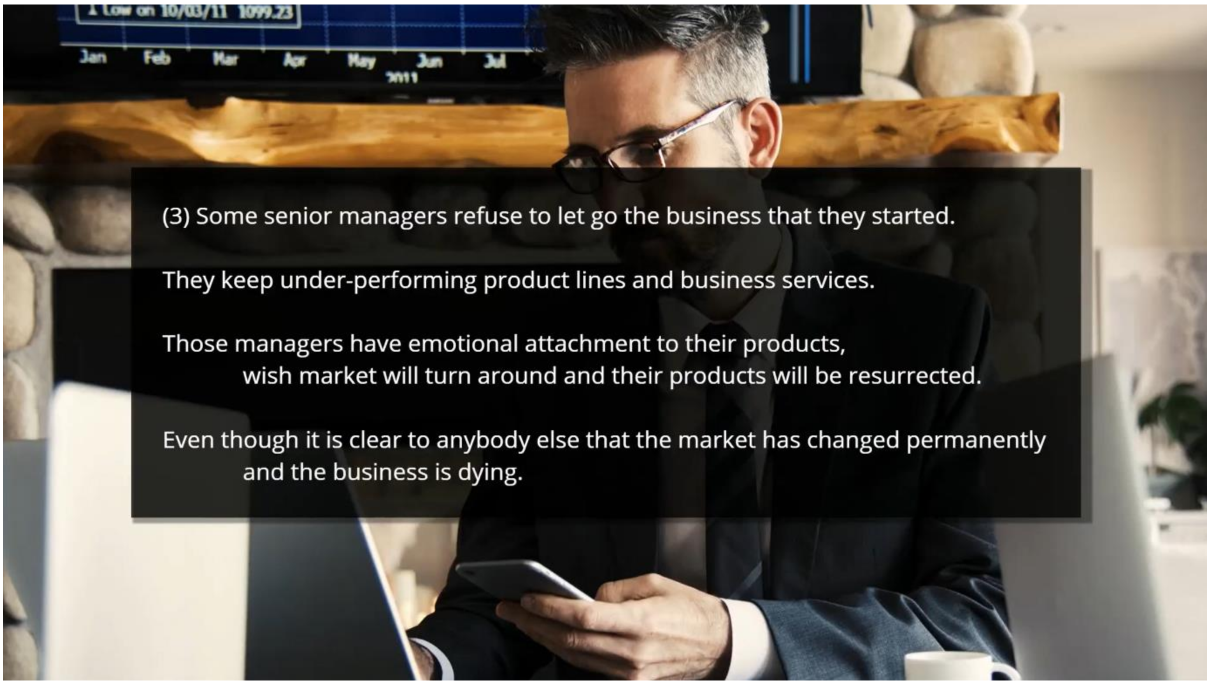

Another common sign of escalation of commitment is senior managers refusing to let go of the business they have started.

They continue underperforming product lines and business services.

Managers who have emotional attachments to their products hope the market will turn around and their products will be resurrected.

Even though it is clear to everybody else that the market has changed permanently and the business is dying.

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Escalation of commitment is also very common in the finance industry.

In the subprime mortgage crisis around 2008, we heard a lot of stories about reputable banks refusing to accept the fact that their loans were bad.

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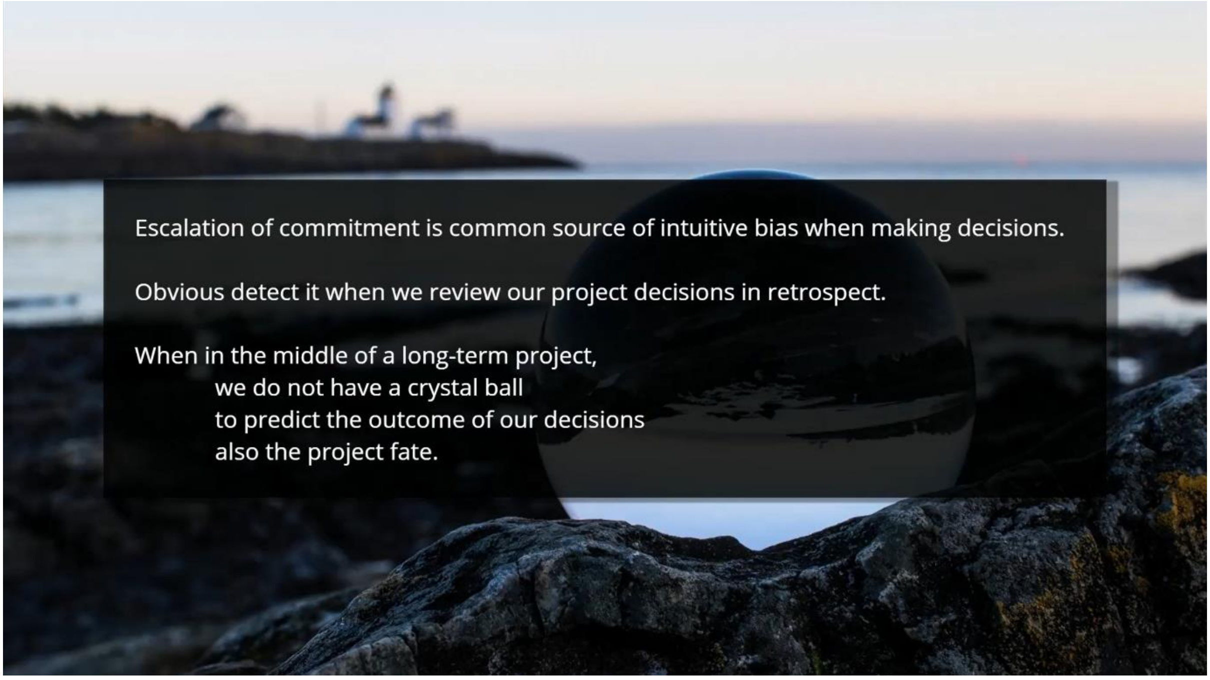

Escalation of commitment is a common source of intuitive bias when we are making decisions.

It might be obvious to detect escalation of commitment when we review our project decisions in retrospect.

However, when we are in the middle of a long-term project, we do not have a crystal ball to predict the outcome of our decisions and the project's fate.

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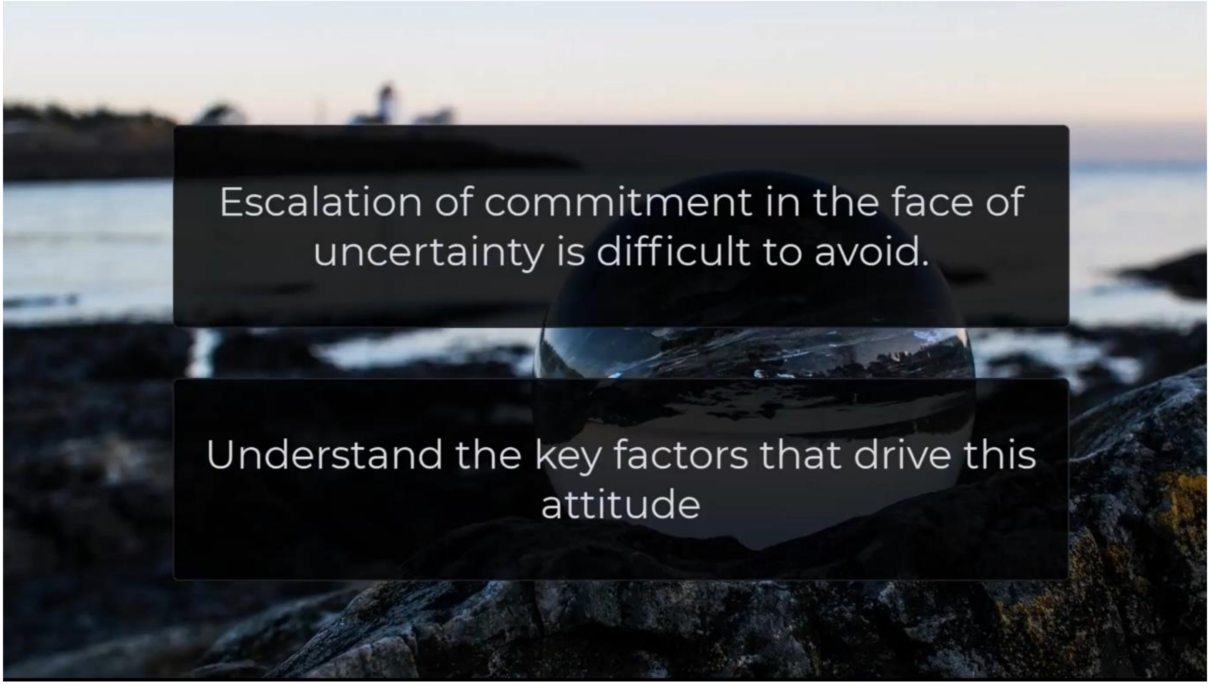

It might be very difficult to avoid escalation of commitment in the face of uncertainty.

In practice, we as senior project managers need to develop a deep understanding of key factors that encourage decision makers to become locked into a losing course of action.

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A practical leadership educator and professor at the Haas Business School at Berkeley, Barry Stahl summarized some key project management situations under which project managers are likely to fall into the escalation of commitment trap.

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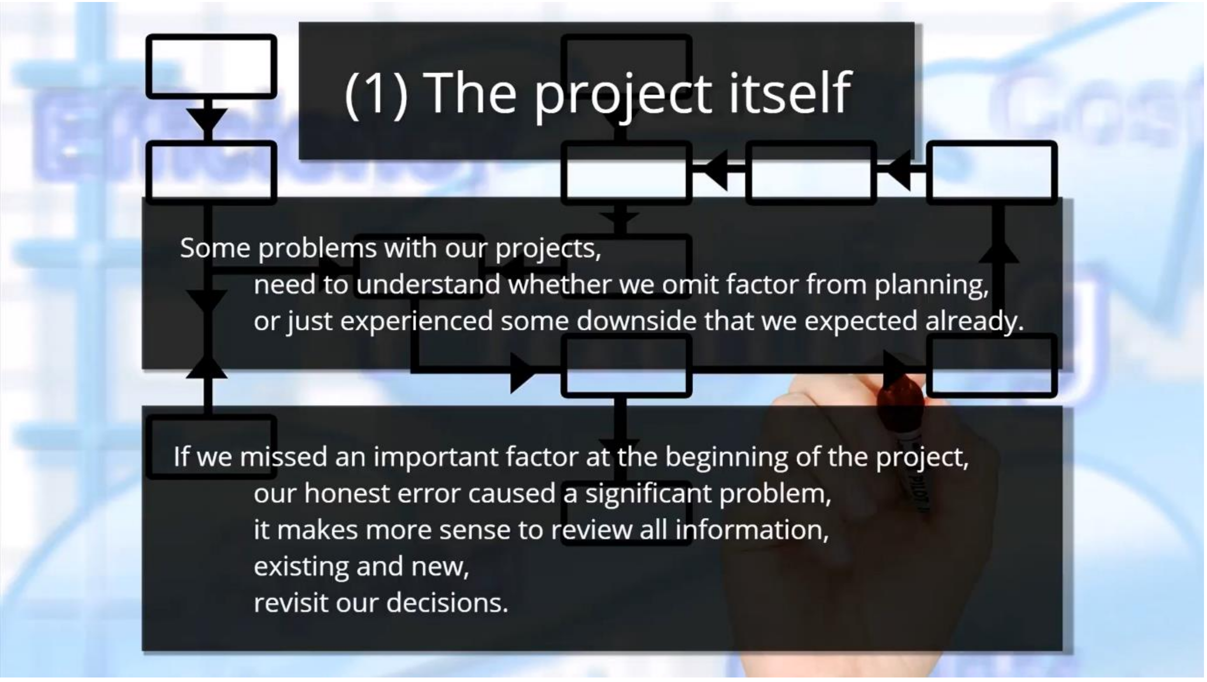

The first set of factors needs to do with the project itself.

When we encounter problems with our projects, we need to understand whether we omitted an important factor from project planning or just experienced some downside that we expected already.

If we missed an important factor at the beginning of the project and our honest error caused a significant problem, it makes more sense to review all information, existing and new, and revisit our decisions.

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Some projects may become irreversible after they start.

For example, it may be very expensive to change the course of a capital project or a real estate development project after the construction work starts.

For those types of irreversible projects, it is very important to be thoughtful in the planning stage.

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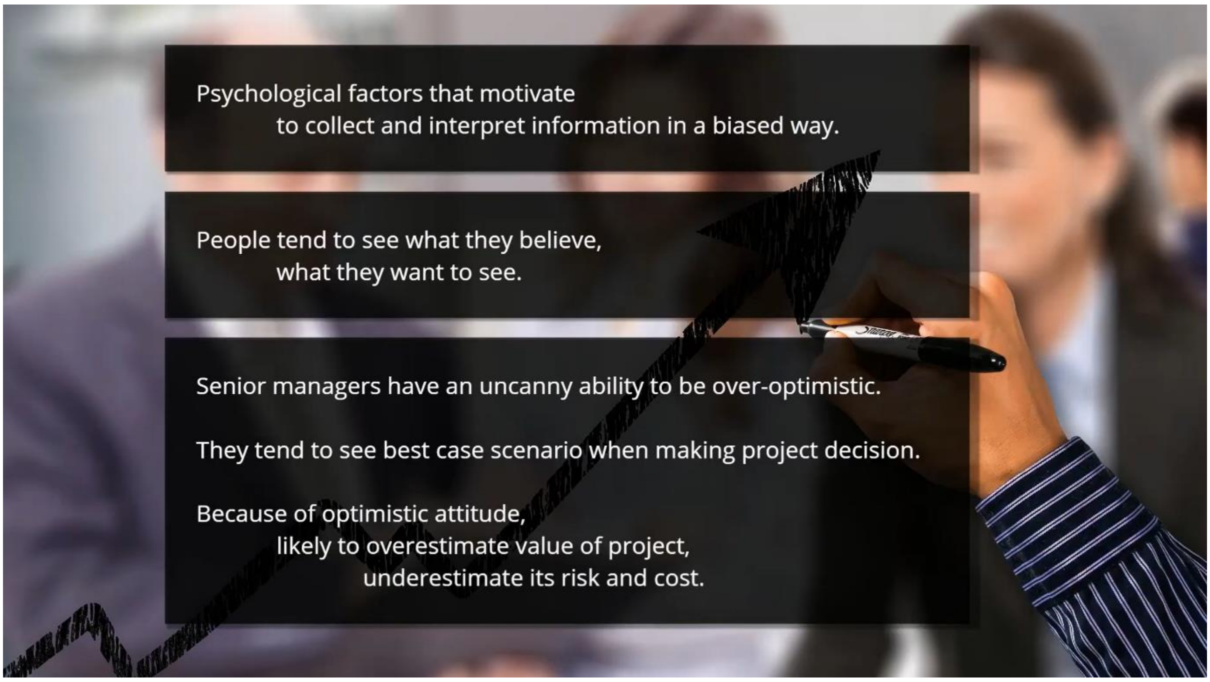

Experienced executives are usually aware of those project factors.

Less obvious to senior managers like you are the psychological factors that motivate those successful senior managers to collect and interpret information in a biased way.

As we discussed, people tend to see what they believe and what they want to see.

Senior managers have an uncanny ability to be over optimistic.

They tend to see the best case scenario when making a project decision.

Because of their optimistic attitude, they are likely to overestimate the value of a project and underestimate its risk and cost.

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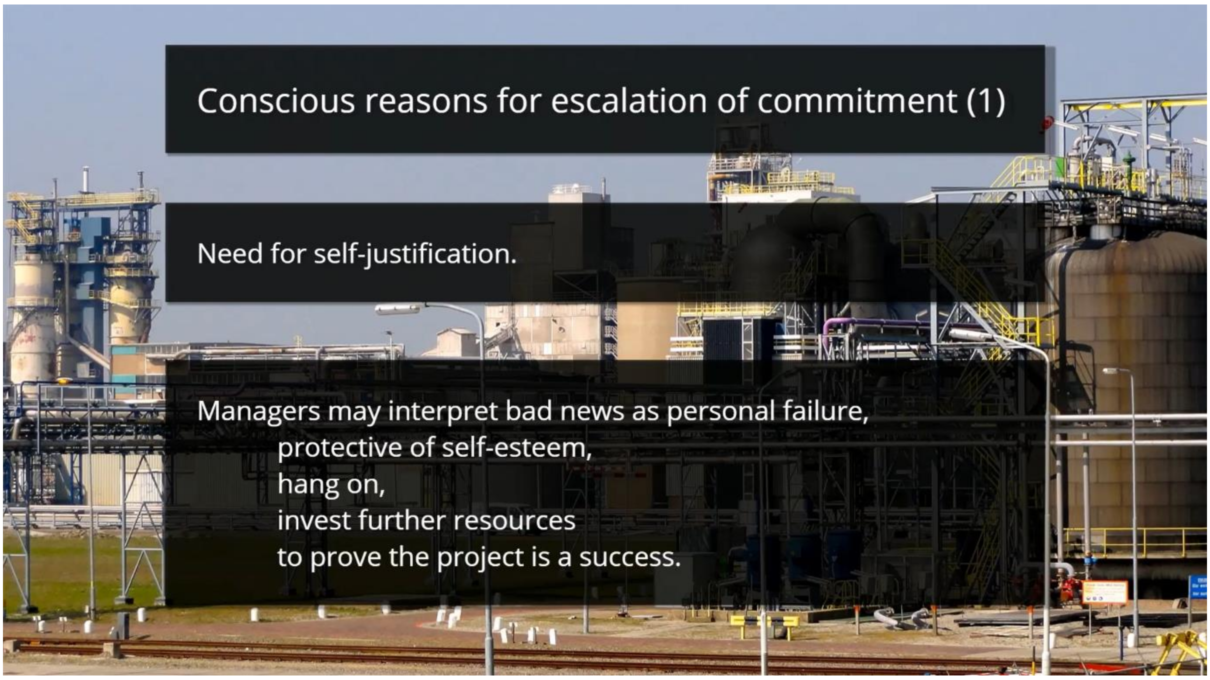

In addition to the unconscious overall optimistic effect, sometimes even when managers recognize that they have suffered losses, they may choose to invest further resources in a project rather than accept failure.

What may be fostering escalation in these cases is a need for a self-justification.

Managers may interpret bad news about our project as a personal failure, and like most of us who are protective of our self-esteem, managers may hang on or even invest further resources to prove the project is a success.

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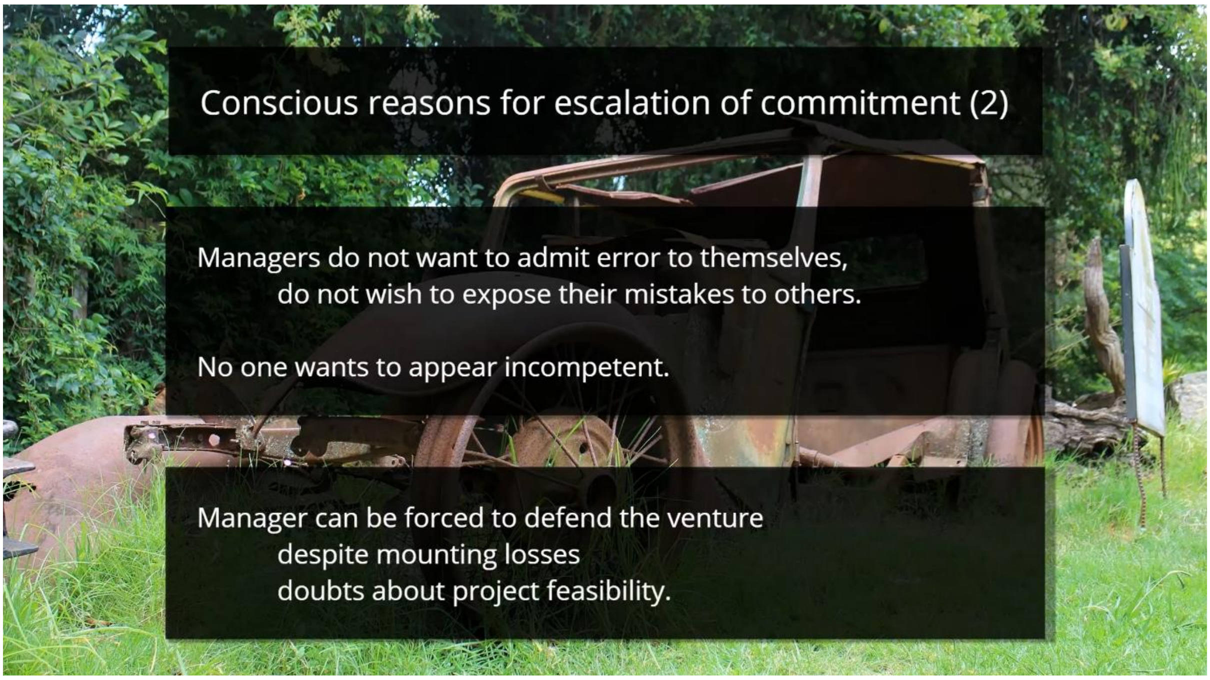

Sometimes, managers may persist in a failing project, not only because they do not want to admit error to themselves, but because they do not wish to expose their mistakes to others, to their peers, and to their management.

No one wants to appear incompetent.

So when a manager's reputation is attached to a project, he or she can be forced to defend the venture, despite mounting losses and doubts about the project's feasibility.

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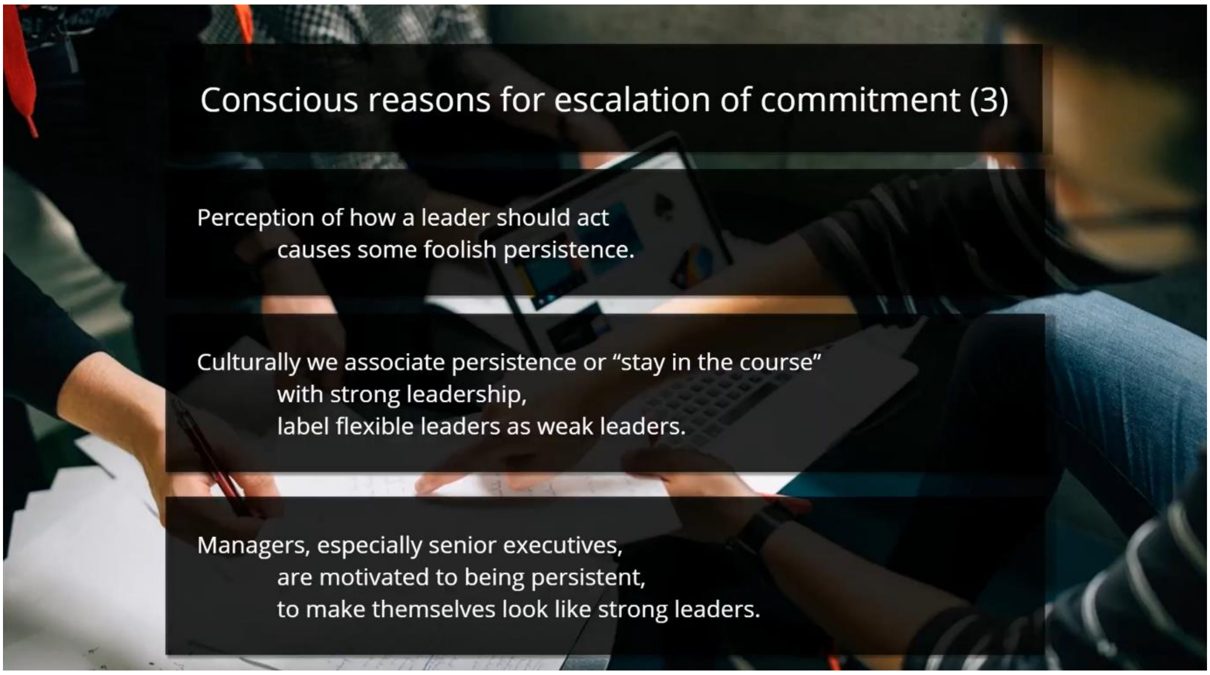

Beyond the personal risks of accepting losses, our perception of how a leader should act also causes some foolish persistence.

Culturally, we associate persistence or staying in the course with strong leadership and label flexible leaders as weak leaders.

So managers, especially senior executives, are motivated to be persistent and to make themselves look like strong leaders.