

THINK AG





AIN:

WHY GOOD LEADERS MAKE BAD DECISIONS

Sydney Finkelstein, Jo Whitehead, and Andrew Campbell studied decisions made around the world and researched those that were flawed at their inception. Their caveats for making decisions will help you to avoid some common errors.

Decision making lies at the heart of our personal and professional lives. Every day we make decisions. Some are small, domestic and innocuous. Others are more important; decisions that affect peoples' lives, livelihoods and well-being. Inevitably, we make mistakes along the way. We are only human – even when we are at work. Indeed, the daunting reality is that enormously important decisions made by intelligent, responsible people with the best information and intentions sometimes go wrong.

Good leaders make bad decisions. Even great leaders can make bad decisions.

US President Kennedy is famous for his blunder over the Bay of Pigs; President Hoover failed to inflate the economy after the great crash of 1929. British Prime Minister Margaret Thatcher championed a “poll tax” that contributed to her being ousted by her own party. Paul Wolfowitz, the former US Deputy Secretary of Defence, was asked to resign as president of the World Bank because of a pay settlement related to his partner, who also worked at the bank.

And it's not just politicians and public servants who get it badly wrong; business leaders, too, are prone to misjudgement. Juergen Schremp, CEO of Daimler Benz, led the merger of Chrysler and Daimler Benz against internal opposition. Nearly 10 years later, Daimler was forced to virtually give

Chrysler away in a private equity deal. Kun-Hee Lee, CEO of Samsung, pushed his company into a disastrous investment in automobiles. As losses mounted, he was forced to sell the car division for a tenth of the billions he had invested. An Wang, founder of the electronics company Wang, insisted on a proprietary operating system for his company's personal computer, even after it was clear that the IBM PC would become the industry standard. The company is now history. Richard Fuld refused to accept the consequences of the worsening credit crisis and consider a sale of Lehman until it was too late. When he was ready, there were no buyers to be found. And CEO Jerry Yang insisted that Yahoo was worth much more than the market, or Microsoft, believed it to be. In the end, his stubborn refusal to consider Microsoft's overture to buy the company cost shareholders \$30 billion and Jerry Yang his job.

Whether the decision is a personal one, as in the case of Wolfowitz, or of global importance, as in the case of the meltdown of the financial markets in 2008, mistakes happen. But why do good leaders make bad decisions? And how can we reduce the risk of it happening to us?

The decisive heart

To find out, we travelled to the heart of decision making in organizations of all shapes and sizes throughout the world. We began by assembling a →

→ database of decisions that went wrong. Let's be clear: we were not looking for decisions that simply turned out badly. We were looking for decisions that were flawed at the time they were made. This is an important point. It isn't that, with 20-20 hindsight, we identified these decisions as flawed. We sought out decisions that any clear-headed analysis at the time of the decision would have concluded to be wrong.

Of course, many indifferent outcomes are due to bad luck or to taking calculated risks. In the business and political worlds in particular, sensible

There are two factors at play in a flawed decision: an individual or group who have made an error of judgement and a decision process that fails to correct the error. Both have to be present to produce a bad decision; this was an important realization. A bad decision starts with at least one influential person making an error of judgement. But, normally, the decision process will save the day: facts will be brought to the table that challenge the flawed thinking or people with different views will influence the outcome. So the second factor

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decisions based on considered thinking can come unstuck thanks to the unavoidable risks involved. Sometimes people are just unlucky.

As you can imagine, trying to distinguish between flawed decisions and calculated risks that turned out badly is not easy. For each situation, we made an assessment: given the information available at the time, did we think that a reasonably competent person would have made the same decision?

We also looked for dissenting views in the decision-making process. The existence of contrary views is not proof that a decision is wrong. Many decisions have contrary views. But, if there were no contrary views at the time, we excluded the decision from our rapidly expanding collection.

We quickly found there are an awful lot of bad decisions out there. Indeed, in unfamiliar circumstances, such as businesses entering new markets or politicians coping with new challenges, flawed decisions abound. We ended up studying 83 different decisions by leaders in business and government.

We are not claiming that we have a unique ability to spot flawed decisions. Indeed, some of the decisions we examined may be considered by others to be wise choices that turned out badly. Fortunately, our argument does not depend on whether our examples are correctly categorized. Our understanding of why flawed decisions are so common comes from work done by neuroscientists and decision scientists to understand how the brain works when faced with a set of circumstances that require a decision.

Flaws of the jungle

So, what did we find in our quest to understand why capable people make errors of judgement? The answers were both more simple and more powerful than we expected.

that contributes is the way the decision is managed: for whatever reason, as the decision is being discussed, the initial erroneous views are not exposed and corrected.

As a result, we focused our research on how our brains make decisions. While the brain has been wonderfully designed for making decisions, it can also be tricked into false judgements.

We identified the four conditions under which flawed thinking is most likely to happen. We call these "red flag conditions", because they provide a warning that, when these conditions exist, even an experienced decision maker may get it wrong. Complex decisions involving interpretation and judgement are difficult to get right. You need debate – but how do you know when you or the other party are arguing from a biased position? You need consensus – but how do you know when your consensus is really groupthink? What is needed is a diagnostic for knowing when the risk of being wrong is at its highest, when the decision maker needs to step back and "think again". Our red flag conditions are a simple, but not simplistic, tool to help decision makers know when to pause for breath – when they need to take special steps to make sure that a decision does not go off the rails.

Misleading experiences are memories that seem similar to the situation we are facing, but are not. They are most likely to disrupt our thinking as we assess the situation, either because we misrecognize the pattern or because the emotion tagged to the pattern gives us an unsuitable action orientation. Misleading experiences contribute to more than half of all flawed decisions. For example, the high profits made from sub-prime lending and the success of CDO vehicles misled bankers across the world, causing them to take risks that now seem foolish.

Misleading pre-judgements are previous decisions or judgements that mislead current judgements. They are most likely to create distortions when we evaluate outcomes: they cause us to get committed to the wrong plans. In addition, they can cause us to fixate on a particular plan of action, often something that has worked in the past. British Prime Minister Tony Blair made a speech in Chicago in 1999 promoting an interventionist policy with regard to “failed states”. This pre-judgement influenced his decision over Iraq.

Inappropriate self-interests are personal interests that conflict with the responsibilities we have for other stakeholders. We routinely ask individuals to leave the meeting or refrain from voting if we know they have a personal interest at stake. In fact, much of the current financial crisis is being blamed on the lack of alignment of interests between highly paid bankers and a stable financial system.

Inappropriate attachments are strong emotional feelings we have towards a group, place or possession that are inappropriate given the decision we are trying to make. In the current climate, in

to eliminate all the risks. Even armed with our safeguards, framework leaders will still make mistakes – but it is possible to improve the odds.

Experience, data, and analysis One type of safeguard is to provide decision makers with new experiences or data and analysis. By doing so, the risk of a flawed decision can be reduced at the source. For example, during the Cuban Missile Crisis, Kennedy needed to know the number, location and state of readiness of Cuba’s missiles in order to judge if it was feasible to carry out a military strike as well as the time available before the Soviets would have a functioning and significant threat to US security. To obtain this information, he had the US Air Force carry out reconnaissance flights.

Group debate and challenge Creating a debate that challenges biases need not involve an elaborate process. It could mean simply chatting about an issue with a friend or colleague. Even if the other person is not an expert, the process of debate can help expose assumptions and beliefs. In large organizations, a typical way to orchestrate debate

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which many organizations need to cut back employment and sell assets, some loyalties will overrule rational downsizing decisions and some assets will be inappropriately retained because “the chairman used to work in that business”.

Each of these red flags can unbalance the mental processes of a decision maker. The leader will feel confident that he or she is making a wise choice, even though the thinking is flawed. As a result, when one or more red flags exist, leaders and their colleagues need to put in place some safeguards.

Safeguarding against bad decisions

Safeguards reduce the risk that red flag conditions will lead to a bad decision: they act as a counterweight. Choosing safeguards is not mechanical. There is no direct link between a particular red flag condition and a particular safeguard. Instead, safeguards need to be chosen not only with an understanding of the red flag conditions, but also with a knowledge of the people and organization as well as a healthy scepticism of too much bureaucracy. Of course it is not possible

and challenge is to form a decision group. The size of the team may vary from two to many, although typically a few people are a better number for a debate. The choice of who should be on the team is vital in defining the quality of challenge that can take place. For example, a UK food company with several business divisions sometimes chooses a manager from a sister division to chair the decision group. The intention is to bring a challenging, and potentially more objective, perspective to the decision. Kennedy’s executive committee was chosen to include diverse views.

Governance Sometimes an open debate is hard to generate or is insufficient to challenge a powerful and strongly entrenched point of view. In this case, the governance team, which approves the proposal submitted by the decision team, may play the critical role. President Kennedy gave himself this role in the Cuban Missile Crisis. In the case of a major acquisition, the decision team might be the CEO and the CFO, and the governance team might be the board led by the chairman. →

→ **Monitoring** This is a normal part of almost every decision. What we are suggesting is that, for those decisions in which there are red flag conditions that are hard to address with the first three categories of safeguard, the last defence is to put in place some extra monitoring. The safeguard is the extra monitoring over and above what would normally be provided. In the case of the Cuban Missile Crisis, Kennedy could not be sure that he had made the right decision. He knew he had limited data about how the Russians would respond to his decision to

into a strong position in digital mobile telephony. Certainly any business school student or strategy analyst worth his salt would have seen this strategy as the “obvious” business move at the time. The only problem with this standard analysis, however, is that it ignores arguably the single most important part of the picture – the decision makers. Decisions don’t just happen by themselves, and don’t take form in some random way. “Objective strategic analysis” is close to useless if the key decision makers are not part of that analysis.

We identified the four conditions under which flawed thinking is most likely to happen. We call these “red flag conditions”.

blockade Cuba. As a result, he opened extra channels of communication with Khrushchev to monitor the impact of the blockade on his thinking. This gave Kennedy more information about the Russian leader’s reactions and helped him come up with the idea of trading the missiles in Turkey for those in Cuba.

In many companies there is a tendency to treat strategic decisions primarily as rational processes of analysis. An organization faces a particular context, defined in terms of competitors, customers, suppliers, regulators and other stakeholders, and seeks ways to best position itself to meet its core objectives. For example, when Motorola looked out at the changing business landscape in the mobile phone business in the 1990s, it saw Nokia and Ericsson shifting from analogue to digital technologies, looked internally to see that it had some of the key capabilities for digital in-house, and quickly moved to take advantage of these key capabilities to push

That’s why it is so important to bring the focus back to the key people in organizations, leaders. At the heart of our analysis is the premise that leaders can make good decisions. But, to do so, we need to broaden their understanding of what happens when they are confronted with the usual mix of unstructured and incomplete data, different perspectives, time pressures and other sources of uncertainty. We all share some common attributes because of how our brains have evolved, and these attributes have much to do with how we think and act. If leaders are unaware of the red flags above, they are vulnerable to making bad decisions that they need not make. ■

Resources

Sydney Finkelstein, Jo Whitehead and Andrew Campbell, *Think Again: Why Good Leaders Make Bad Decisions and How to Keep it From Happening to You*, Harvard Business Press, 2009.

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