How to Make Great Leadership Decisions

The normal state of your mind is that you have intuitive feelings and opinions about almost everything that comes your way. ~ Daniel Kahneman, Nobel Prize laureate in economics

We are quick to pass judgment and make snap decisions. The smarter and more educated we are, the more overconfident we are about our conclusions.

Humanity doesn't have a good track record for decision-making. Businesses are even more notorious for failed product launches, mergers and acquisitions.

Clearly, our brains are flawed when it comes to making sound choices. We are easily biased, prone to influence from emotions and at times irrational without conscious awareness.

Researchers have long studied failed business decisions to identify common stumbling blocks. Given that we're more irrational than we'd like to believe, how can we improve the quality of our leadership decisions?

Decisions: Based on Analysis or Process?

Leaders often carefully analyze numbers to make important decisions:

- Should we launch a new product or service?
- Should we change our organizational structure?
- Should we expand to a new country?
- Should we acquire another firm?

They also consider intuitive decision processes:

- Discussion of uncertainties
- Inclusion of contrary perspectives

A Message from Nancy...

I have a couple of questions to ask you:

1. Is your business as successful as you think it should be?

2. Are you and your team able to pinpoint the solutions necessary to create positive changes to get where you need to go?

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- Interviewing a range of people with other ideas

- Exploration of alternative ideas

Business professor Dan Lovallo and consultant Olivier Sibony tracked more than 2,200 business decisions over five years to determine how they were made: analysis or process ("The Case for Behavioral Strategy," *McKinsey Quarterly*, March 2010).

After examining outcomes (revenues, profits and market share), they found that "process mattered more than analysis — by a factor of six."

"Superb analysis is useless," they concluded, "unless the decision process gives it a fair hearing."

Yet, many business leaders are skeptical about the value of a decision process over hard-number analyses. The research is nonetheless clear: A better decision process substantially improves results and associated financial returns.

Avoiding Errors

Each of us can learn to recognize faulty thinking that contributes to decision errors:

- **Confirmation bias** — A tendency to favor information that confirms our existing beliefs

- **The status-quo trap** — An irrational preference for the current state of affairs. The current baseline serves as a reference point, and any deviation is perceived as a loss.

- **Loss aversion** — A tendency to strongly prefer avoiding losses over acquiring gains. Some studies suggest losses are psychologically twice as powerful as gains.

- **Sunk-costs fallacy** — When people make decisions about a current situation based on what they have already invested

- **Planning fallacy** — Estimating and forecasting errors occur when an optimism bias influences decisions and forecasts in policy, planning and management. Leaders tend to underestimate costs and overestimate completion times.

Awareness of biases is necessary, but it won't necessarily prevent problems. It's hard to correct for errors with only simple awareness. Most of us over-rely on data to support our decisions, without realizing that we unconsciously select facts and figures that confirm our preexisting ideas and opinions.

One of the most popular decision-making processes is the pros-and-cons list, which requires us to weigh opposing points of views. It makes sense, and it's easy to use. But over the last 40 years, psychology researchers have identified thinking biases that doom this decision-making model. There are more productive processes for making good decisions.

The WRAP Process

Professors Chip and Dan Heath propose the "WRAP Process" in *Decisive: How to Make Better Choices in Life and Work* (Random House Digital, Inc., 2013):

1. **W = Widen Your Options:** When confronted with a decision, we have a tendency to define it within a narrow frame. Should we do this...or not? This way...or that way? Instead, we should substitute "and" for "or." Narrow framing creates missed options and opportunities.

2. **R = Reality-Test Your Assumptions:** When analyzing options, you gather information (both pro and con). But it's hard to escape confirmation biases that unconsciously draw you to selecting self-serving information.

3. **A = Attain Distance before Deciding:** You probably pride yourself on your ability to sift through data and be decisive, but no one is immune from emotional influences. Feelings can drive you to make wrong decisions unless you gain some distance.

4. **P = Prepare to Be Wrong:** Once we make a decision, we look for confirming evidence that we're right. Most of us are overconfident about how the future will unfold. But no one is immune from forecasting errors and the planning fallacy. We can help ensure success by preparing to be wrong.

Fast and Slow Thinking

Kahneman writes in *Thinking, Fast and Slow* (Farrar, Straus and Giroux, 2011):

My intuitive thinking is just as prone to overconfidence, extreme predictions, and

the planning fallacy as it was before I made a study of these issues. I have improved only in my ability to recognize situations in which errors are likely.

Kahneman simplifies the mind's decision-making process by dividing it into Systems 1 and 2.

System 1 is fast, routinely guiding our thoughts and actions — and it's generally on the mark. Our associative memory maintains a richly detailed model of our world, as well as a vast repertoire of skills acquired over a lifetime of practice. This allows us to produce remarkable solutions to everyday challenges.

System 2 is slow. It represents our rational self (who we think we are). It articulates judgments and makes choices, but it often endorses or rationalizes ideas and feelings generated by System 1.

But System 2 isn't merely an apologist for System 1; it also prevents many foolish thoughts and inappropriate impulses from becoming overt expressions. System 2 is not always rational, and we don't always think straight. We often make mistakes because we don't know any better.

System 1 simultaneously generates answers to related questions, and may substitute a response that more easily comes to mind for the one that was requested. By using heuristics, it quickly provides probable answers that are often correct— but sometimes they are quite wrong.

There is no way for System 2 to know if a System 1 answer is a skilled or heuristic response without slowing down and attempting to construct an answer on its own. But this is a slow and arduous thinking process, which the brain resists.

And so, we are prone to thinking errors. System 1 is not readily educable. The only recourse is to recognize you are in a cognitive minefield, slow down and ask for System 2 reinforcement.

No warning bell rings. "The voice of reason may be much fainter than the loud and clear voice of an erroneous intuition, and questioning your intuitions is unpleasant when you face the stress of a big decision," according to Kahneman. "More doubt is the last thing you want when you are in trouble."

It's usually easier to spot a minefield when you see others wander into it. This is why smart leaders work with senior leadership teams. Observers are less cognitively mired and more open to information than those who are intensely involved.

Organizational Thinking

Organizations can avoid decision errors by requiring leaders and managers to use checklists, while fostering a culture where people watch out for one another. Team members should be taught to guard against biases and develop a sophisticated awareness of decision-making obstacles.

Every organization is essentially a factory that manufactures judgments and decisions. It must therefore work to ensure the quality of its "products" at every developmental stage, to include:

- Framing of the problem to be solved

- Collection of relevant information

- Consideration of alternative points of view

- Reflection, forecasting and pre-mortem reviews

Setting up decision processes and ensuring quality control are alternatives to conducting a postmortem review in the wake of a disaster. We truly need a better vocabulary for decision-making processes. As Kahneman writes:

Ultimately, a richer language is essential to the skill of constructive criticism. Much like medicine, the identification of judgment errors is a diagnostic task, which requires a precise vocabulary. ...Similarly [to diagnostic labels for diseases]*, labels such as "anchoring effects," "narrow framing," or "excessive coherence" bring together in memory everything we know about a bias, its causes, its effects, and what can be done about it.*

Leaders will make better choices when they trust the decision-making process and their critics to be informed and fair, and when their decision is judged by how it was made — not only by how it turned out.

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