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# Systematic Decision Errors

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Turnaround professionals and their clients often find themselves making difficult decisions under extremely stressful conditions. The ability to make good decisions during a crisis when the stakes are high is a hallmark of the effective turnaround professional. This article highlights some key findings from behavioral science studies conducted on the decision-making process and how intelligent, competent people inadvertently make decision errors. There are several recognized, systematic decision-making errors that commonly affect even the most sophisticated, experienced and highly trained decision makers, so identifying and avoiding these systematic errors is a worthwhile effort for everyone.

The most important (but often overlooked) step in the decision-making process is the preliminary assessment of the problem. The purpose of this initial step is to consider the decision within the context of all the relevant high level issues. This big picture perspective provides a platform from which to effectively plan the entire decision-making process. The theme for this step is "a problem well stated is a problem half solved." How you approach the remaining steps of framing the situation, gathering intelligence, coming to conclusions and learning from experience will flow from the preliminary assessment. While this concept seems elementary, failing to consciously and adequately focus on this initial step can easily lead to a flawed process and decision.

The next steps in the decision-making process are framing the problem and identifying options. Frames have several features that distort thinking, and the way a situation is framed will determine the issues we focus on, the options we recognize and the solutions we choose. The difficulty of properly framing decisions increases with the complexity of the circumstances under consideration. Failing to identify enough alternatives is a very common decision-making error. It can be difficult to imagine all the ways events can unfold. The process of identifying options requires considerable focus, creativity and patience, and is easily short-changed under stressful conditions. The goal is to identify as many viable alternatives as possible, and then perform scenario planning to rank them. Qualifying alternatives should be evaluated through a decision tree analysis by applying a value and probability (incorporating both qualitative and quantitative factors) to each outcome. Many professionals perform this probability analysis subconsciously; however formalizing the process can greatly reduce the risk of overconfidence decision errors.

Failing to accurately estimate probabilities is another common decision error. Researchers have found that people tend to be wildly overconfident in their judgments. Overconfidence systematically arises among even the most skilled decision makers as a result of heuristics and biases. Heuristics are rules of thumb that people follow, often subconsciously, in order to make judgments quickly and efficiently in the face of overwhelming amounts of information. While generally useful, they lead to systematic judgmental biases that we should be aware of. Three common heuristics are Representativeness, Adjustment and Anchoring. These dynamics frequently cause people to apply overconfident probabilities to successful outcomes, resulting in flawed decisions.

The Representativeness heuristic, also termed the Illusion of Validity, is the

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tendency to erroneously apply concepts or conclusions from other seemingly similar situations to the one at hand. The Adjustment heuristic is the tendency to make insufficient adjustments when estimating probabilities of events that vary from a particular starting point. The Anchoring heuristic is the tendency to overestimate the probability of conjunctive events (leading to excessive optimism that a plan will succeed) and underestimate the likelihood of failure in complex systems. Anchoring also causes people to have overly narrow confidence intervals that reflect more certainty than is justified by their knowledge. Again, these surprisingly persistent tendencies impact highly skilled decision makers and should be carefully considered when applying probabilities to alternatives in the decision tree. Underestimating their impact can lead to costly decision-making mistakes.

Another common error occurs during the "lessons learned" analysis after the decision-making process is complete. There is a tendency to judge the quality of a decision by the resulting outcome, based on the faulty assumption that if a desirable outcome occurred then the

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related decision must have been a good one, and vice-versa. We can't ignore the impact that luck and uncontrollable circumstances have on outcomes. A skillful decision maker using a rigorous and effective process will arrive at a statistically optimal decision, which will often result in a positive outcome, and an incompetent decision maker will occasionally stumble upon a decision that results in a positive outcome. It would be a mistake to measure the quality of the decision (and the skill of the decision maker) solely by the outcome. Experts agree that a "good" decision is defined by a rigorous and effective decision-making process that results in the selection of the statistically superior option.

Of course clients only care about results, so a "good" decision from a client's perspective is one that achieves a desired outcome. How do we reconcile that reality with the experts' definition of a "good" decision? When choosing an advisor, should clients care how skillful a professional is in making rigorous, statistically superior decisions, or should they focus on track record? Is a "shoot from the hip" decision maker with some recent "wins" a better choice than a skillful decision maker with some recent "losses"? What if the wins were based on simple assignments with easy, predictable solutions while the losses occurred on complex assignments with difficult and uncontrollable circumstances? Certainly the skillful decision maker would have performed well on the easy assignments, but how would the "shoot from the hip" professional have performed on the difficult assignments? Comparing short-term track records can be tricky, but over time, statistically optimal decisions prevail. Professionals using a sound decision-making process will be those with the most consistently successful track records because their decisions will result in positive outcomes more often than those made by professionals with sloppy decision-making skills.

How do experience and education affect the decision-making process? They both go a long way toward avoiding decision-making errors. Professionals who truly understand the complexities of the issues at hand, either through experience or through advanced education and technical training, will be able to generate more viable alternatives and better estimate probabilities than professionals with less experience or education. Neither experience nor education, however, will be of much help in the absence of a sound decision-making process. We all know of professionals who have "been around forever" but not managed to build successful track records, and we all know of technical experts who struggle with the "big picture" and practical solutions. When choosing an advisor, clients should focus first on the quality of a professional's decision-making skills because neither experience nor education matter without them.

One of the most difficult decisions that turnaround professionals and their clients can face is whether or not to close down a failing business. While decisions based on quantitative factors might be fairly straight forward, clients can also be driven by deeply compelling and overwhelmingly complex qualitative factors. For example, a client who has spent a lifetime building a business may have an intense aversion to closing it. Emotional attachment to the business and the perception that closing it represents a personal failure can distort reasoning. Clients will be particularly susceptible to making decision errors under these circumstances.

An effective turnaround professional facilitates the client's decision-making process by ensuring that all the relevant issues, both obvious and nebulous, are identified, articulated and fully explored, and by assisting in the identification and ranking of potential alternatives. For example, a client who enjoys running a business and is not ready to retire might fail to recognize the possibility of launching or purchasing another viable business rather than clinging to a failing one. Effective professionals also assist clients in recognizing and avoiding overconfidence decision errors arising from heuristics and biases. For example, a client who was able to pull a struggling business through a rough patch years ago might succumb to the Illusion of Validity by assuming that it can be done again, perhaps ignoring fundamental changes in the economic environment that will prevent a recovery this time around.

Decisions made during a turnaround situation are often characterized by incredible complexity, pressure and consequence. Take the time to perform a thorough assessment of the problem at hand, focus on properly framing the decision and consider as many alternatives as possible. Then guard against the effects of heuristics and biases as you analyze your options and draw conclusions. Remember that a good decision is defined by an effective and optimal decision-making process, not by the outcome. Good luck!

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