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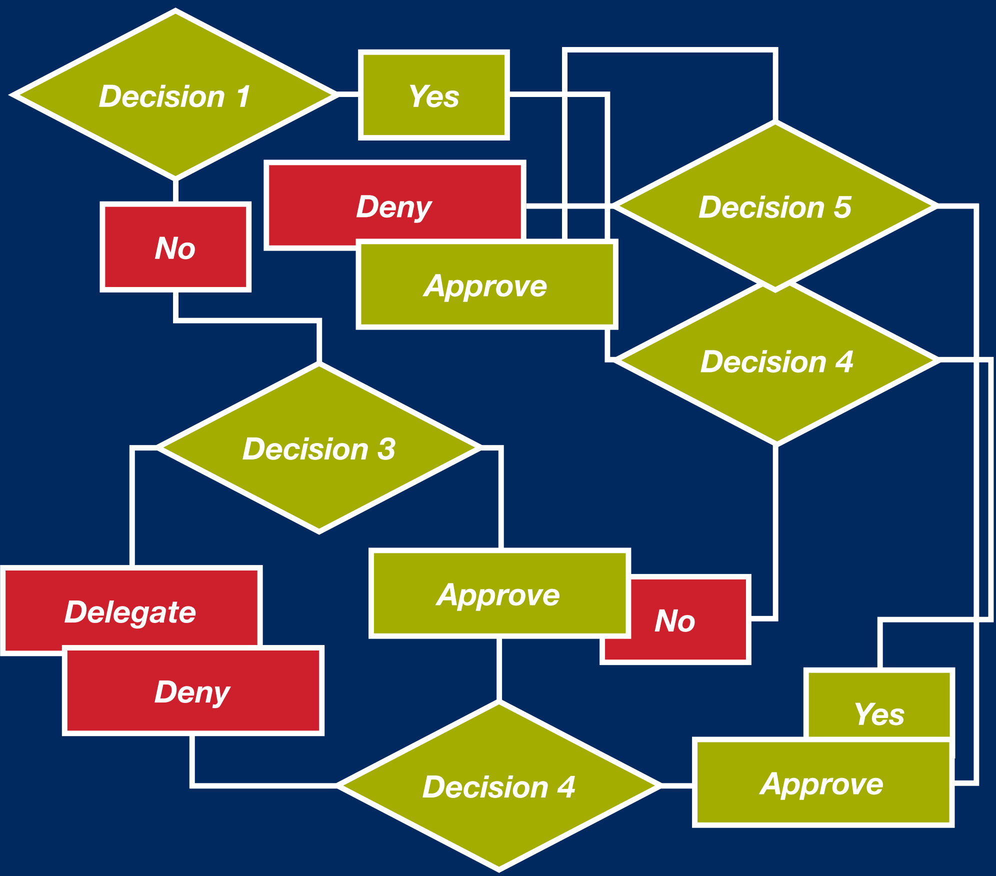

BETTER DECISIONS

IN THIS EDITION:

McKinsey Quarterly

The case for behavioral strategy

Dan Lovallo and Olivier Sibony

Left unchecked, subconscious biases will undermine strategic decision making. Here's how to counter them and improve corporate performance.

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Once heretical, behavioral economics is now mainstream. Money managers employ its insights about the limits of rationality in understanding investor behavior and exploiting stock-pricing anomalies. Policy makers use behavioral principles to boost participation in retirement-savings plans. Marketers now understand why some promotions entice consumers and others don't.

Yet very few corporate strategists making important decisions consciously take into account the cognitive biases—systematic tendencies to deviate from rational calculations—revealed by behavioral economics. It's easy to see why: unlike in fields such as finance and marketing, where executives can use psychology to make the most of the biases residing in *others*, in strategic decision making leaders need to recognize *their own* biases. So despite growing awareness of behavioral economics and numerous efforts by management writers, including ourselves, to make the case for its application, most executives have a justifiably difficult time knowing how to harness its power.[1]

This is not to say that executives think their strategic decisions are perfect. In a recent *McKinsey Quarterly* survey of 2,207 executives, only 28 percent said that the quality of strategic decisions in their companies was generally good, 60 percent thought that bad decisions were about as frequent as good ones, and the remaining 12 percent thought good decisions were altogether infrequent.[2] Our candid conversations with senior executives behind closed doors reveal a similar unease with the quality of decision making and confirm the significant body of research indicating that cognitive biases affect the most important strategic decisions made by the smartest managers in the best companies. Mergers routinely fail to deliver the expected synergies.[3] Strategic plans often ignore competitive responses.[4] And large investment projects are over budget and over time—over and over again.[5]

In this article, we share the results of new research quantifying the financial benefits of processes that "debias" strategic decisions. The size of this prize makes a strong case for practicing behavioral strategy—a style of strategic decision making that incorporates the lessons of psychology. It starts with the recognition that even if we try, like Baron Münchhausen, to escape the swamp of biases by pulling ourselves up by our own hair, we are unlikely to succeed. Instead, we need new norms for activities such as managing meetings (for more on running unbiased meetings, see "Taking the bias out of meetings" on mckinsey.com/quarterly), gathering data, discussing analogies, and stimulating debate that together can diminish the impact of cognitive biases on critical decisions. To support those new norms, we also need a simple language for recognizing and discussing biases, one that is grounded in the reality of corporate life, as opposed to the sometimes-arcane language of academia. All this represents a significant commitment and, in some organizations, a profound cultural change.

[1] See Charles Roxburgh, "Hidden flaws in strategy," mckinsey.com/quarterly, May 2003; and Dan P. Lovallo and Olivier Sibony, "Distortions and deceptions in strategic decisions," mckinsey.com/quarterly, February 2006.
[2] See "Flaws in strategic decision making: McKinsey Global Survey Results," mckinsey.com/quarterly, January 2009.
[3] See Dan Lovallo, Patrick Viguerie, Robert Uhlaner, and John Horn, "Deals without delusions," *Harvard Business Review,* December 2007, Volume 85, Number 12, pp. 92–99.
[4] See John T. Horn, Dan P. Lovallo, and S. Patrick Viguerie, "Beating the odds in market entry," mckinsey.com/quarterly, November 2005.
[5] See Bent Flyvbjerg, Dan Lovallo, and Massimo Garbuio, "Delusion and deception in large infrastructure projects," *California Management Review,* 2009, Volume 52, Number 1, pp. 170–93.

What we did

1,048 Number of decisions analyzed

76% Share of decisions related to M&A, organizational change, or expansion into new geographies, products, and services

51% Proportion of decisions that could be attributed to a single, specific business function (sales, R&D, marketing, manufacturing, or supply chain/distribution)

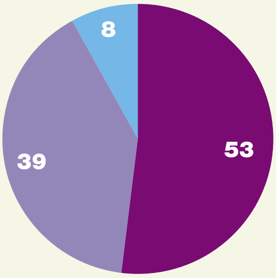
The value of good decision processes

Think of a large business decision your company made recently: a major acquisition, a large capital expenditure, a key technological choice, or a new-product launch. Three things went into it. The decision almost certainly involved some fact gathering and analysis. It relied on the insights and judgment of a number of executives (a number sometimes as small as one). And it was reached after a process—sometimes very formal, sometimes completely informal—turned the data and judgment into a decision.

Our research indicates that, contrary to what one might assume, good analysis in the hands of managers who have good judgment won't naturally yield good decisions. The third ingredient—the process—is also crucial. We discovered this by asking managers to report on both the nature of an important decision and the process through which it was reached. In all, we studied 1,048 major decisions made over the past five years, including investments in new products, M&A decisions, and large capital expenditures.

Process, analysis, and industry variables explain decision-making effectiveness

Share of performance explained by given element
(based on multivariate regression analysis), %



Note: To evaluate decision-making effectiveness, we asked respondents to assess outcomes along four dimensions: revenue, profitability, market share, and productivity.

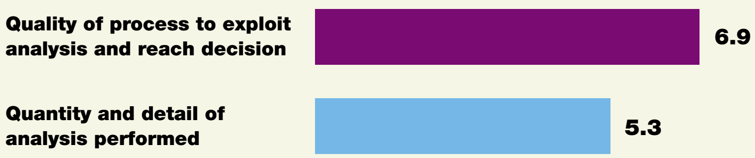
We asked managers to report on the extent to which they had applied 17 practices in making that decision. Eight of these practices had to do with the quantity and detail of the analysis: did you, for example, build a detailed financial model or run sensitivity analyses? The others described the decision-making process: for instance, did you explicitly explore and discuss major uncertainties or discuss viewpoints that contradicted the senior leader's? We chose these process characteristics because in academic research and in our experience, they have proved effective at overcoming biases.[6]

After controlling for factors like industry, geography, and company size, we used regression analysis to calculate how much of the variance in decision outcomes[7] was explained by the quality of the process and

[6] Research like this is challenging because of what International Institute for Management Development (IMD) professor Phil Rosenzweig calls the "halo effect": the tendency of people to believe that when their companies are successful or a decision turns out well, their actions were important contributors (see Phil Rosenzweig, "The halo effect, and other managerial delusions," mckinsey.com/quarterly, February 2007). We sought to mitigate the halo effect by asking respondents to focus on a typical decision process in their companies and to list several decisions before landing on one for detailed questioning. Next, we asked analytical and process questions about the specific decision for the bulk of the survey. Finally, at the very end of it, we asked about performance metrics.

[7] We asked respondents to assess outcomes along four dimensions: revenue, profitability, market share, and productivity.

Difference in ROI between top- and bottom-quartile decision inputs, percentage points



how much by the quantity and detail of the analysis. The answer: process mattered more than analysis—by a factor of six. This finding does not mean that analysis is unimportant, as a closer look at the data reveals: almost no decisions in our sample made through a very strong process were backed by very poor analysis. Why? Because one of the things an unbiased decision-making process will do is ferret out poor analysis. The reverse is not true; superb analysis is useless unless the decision process gives it a fair hearing.

To get a sense of the value at stake, we also assessed the return on investment (ROI) of decisions characterized by a superior process.[8] The analysis revealed that raising a company's game from the bottom to the top quartile on the decision-making process improved its ROI by 6.9 percentage points. The ROI advantage for top-quartile versus bottom-quartile analytics was 5.3 percentage points, further underscoring the tight relationship between process and analysis. Good process, in short, isn't just good hygiene; it's good business.

[8]This analysis covers the subset of 673 (out of all 1,048) decisions for which ROI data were available.

The building blocks of behavioral strategy

Any seasoned executive will of course recognize some biases and take them into account. That is what we do when we apply a discount factor to a plan from a direct report (correcting for that person's overoptimism). That is also what we do when we fear that one person's recommendation may be colored by self-interest and ask a neutral third party for an independent opinion.

However, academic research and empirical observation suggest that these corrections are too inexact and limited to be helpful. The prevalence of biases in corporate decisions is partly a function of habit, training, executive selection, and corporate culture. But most fundamentally, biases are pervasive because they are a product of human nature—hard-wired and highly resistant to feedback, however brutal. For example, drivers laid up in hospitals for traffic accidents they themselves caused overestimate their driving abilities just as much as the rest of us do.[9]

Improving strategic decision making therefore requires not only trying to limit our own (and others') biases but also orchestrating a decision-making process that will confront different biases and limit their impact. To use a judicial analogy, we cannot trust the judges or the jurors to be infallible; they are, after all, human. But as citizens, we can expect verdicts to be rendered by juries and trials to follow the rules of due process. It is through teamwork, and the process that organizes it, that we seek a high-quality outcome.

Building such a process for strategic decision making requires an understanding of the biases the process needs to address. In the discussion that follows, we focus on the subset of biases we have found to be most relevant for executives and classify those biases into five simple, business-oriented groupings (for more on these groupings, see "A language to discuss biases"). A familiarity with this classification is useful in itself because, as the psychologist and Nobel laureate in economics Daniel Kahneman has pointed out, the odds of defeating biases in a group setting rise when discussion of them is widespread. But familiarity alone isn't enough to ensure unbiased decision making, so as we discuss each family of bias, we also provide some general principles and specific examples of practices that can help counteract it.

Counter pattern-recognition biases by changing the angle of vision

The ability to identify patterns helps set humans apart but also carries with it a risk of misinterpreting conceptual relationships. Common

[9] Caroline E. Preston and Stanley Harris, "Psychology of drivers in traffic accidents," *Journal of Applied Psychology,* 1965, Volume 49, Number 4, pp. 284–88.

In most organizations, an executive who projects great confidence in a plan is more likely to get it approved than one who lays out all the risks and uncertainties surrounding it

pattern-recognition biases include saliency biases (which lead us to overweight recent or highly memorable events) and the confirmation bias (the tendency, once a hypothesis has been formed, to ignore evidence that would disprove it). Particularly imperiled are senior executives, whose deep experience boosts the odds that they will rely on analogies, from their own experience, that may turn out to be misleading.[10] Whenever analogies, comparisons, or salient examples are used to justify a decision, and whenever convincing champions use their powers of persuasion to tell a compelling story, pattern-recognition biases may be at work.

Pattern recognition is second nature to all of us—and often quite valuable—so fighting biases associated with it is challenging. The best we can do is to change the angle of vision by encouraging participants to see facts in a different light and to test alternative hypotheses to explain those facts. This practice starts with things as simple as field and customer visits. It continues with meeting-management techniques such as reframing or role reversal, which encourage participants to formulate alternative explanations for the evidence with which they are presented. It can also leverage tools, such as competitive war games, that promote out-of-the-box thinking.

Sometimes, simply coaxing managers to articulate the experiences influencing them is valuable. According to Kleiner Perkins partner Randy Komisar, for example, a contentious discussion over manufacturing strategy at the start-up WebTV [11] suddenly became much more manageable once it was clear that the preferences of executives about which strategy to pursue stemmed from their previous career

[10] For more on misleading experiences, see Sydney Finkelstein, Jo Whitehead, and Andrew Campbell, *Think Again: Why Good Leaders Make Bad Decisions and How to Keep It from Happening to You,* Boston: Harvard Business Press, 2008.
[11] WebTV is now MSN TV.

experience. When that realization came, he told us, there was immediately a "sense of exhaling in the room." Managers with software experience were frightened about building hardware; managers with hardware experience were afraid of ceding control to contract manufacturers.

Getting these experiences into the open helped WebTV's management team become aware of the pattern recognition they triggered and see more clearly the pros and cons of both options. Ultimately, WebTV's executives decided both to outsource hardware production to large electronics makers and, heeding the worries of executives with hardware experience, to establish a manufacturing line in Mexico as a backup, in case the contractors did not deliver in time for the Christmas season. That in fact happened, and the backup plan, which would not have existed without a decision process that changed the angle of vision, "saved the company."

Another useful means of changing the angle of vision is to make it wider by creating a reasonably large—in our experience at least six—set of similar endeavors for comparative analysis. For example, in an effort to improve US military effectiveness in Iraq in 2004, Colonel Kalev Sepp—by himself, in 36 hours—developed a reference class of 53 similar counterinsurgency conflicts, complete with strategies and outcomes. This effort informed subsequent policy changes.[12]

Counter action-oriented biases by recognizing uncertainty

Most executives rightly feel a need to take action. However, the actions we take are often prompted by excessive optimism about the future and especially about our own ability to influence it. Ask yourself how many plans you have reviewed that turned out to be based on overly optimistic forecasts of market potential or underestimated competitive responses. When you or your people feel—especially under pressure—an urge to take action and an attractive plan presents itself, chances are good that some elements of overconfidence have tainted it.

To make matters worse, the culture of many organizations suppresses uncertainty and rewards behavior that ignores it. For instance, in most organizations, an executive who projects great confidence in a plan is more likely to get it approved than one who lays out all the risks and uncertainties surrounding it. Seldom do we see confidence as a warning sign—a hint that overconfidence, overoptimism, and other action-oriented biases may be at work.

Superior decision-making processes counteract action-oriented biases by promoting the recognition of uncertainty. For example, it often

[12] Thomas E. Ricks, *Fiasco: The American Military Adventure in Iraq,* New York: Penguin Press, 2006, pp. 393–94.

helps to make a clear and explicit distinction between decision meetings, where leaders should embrace uncertainty while encouraging dissent, and implementation meetings, where it's time for executives to move forward together. Also valuable are tools—such as scenario planning, decision trees, and the "premortem" championed by research psychologist Gary Klein (for more on the premortem, see "Strategic decisions: When can you trust your gut?" on mckinsey.com/quarterly)—that force consideration of many potential outcomes. And at the time of a major decision, it's critical to discuss which metrics need to be monitored to highlight necessary course corrections quickly.

Counter stability biases by shaking things up

In contrast to action biases, stability biases make us less prone to depart from the status quo than we should be. This category includes anchoring—the powerful impact an initial idea or number has on the subsequent strategic conversation. (For instance, last year's numbers are an implicit but extremely powerful anchor in any budget review.) Stability biases also include loss aversion—the well-documented tendency to feel losses more acutely than equivalent gains—and the sunk-cost fallacy, which can lead companies to hold on to businesses they should divest.[13]

One way of diagnosing your company's susceptibility to stability biases is to compare decisions over time. For example, try mapping the percentage of total new investment each division of the company receives year after year. If that percentage is stable but the divisions' growth opportunities are not, this finding is cause for concern—and quite a common one. Our research indicates, for example, that in multi-business corporations over a 15-year time horizon, there is a near-perfect correlation between a business unit's current share of the capital expenditure budget and its budget share in the previous year. A similar inertia often bedevils advertising budgets and R&D project pipelines.

One way to help managers shake things up is to establish stretch targets that are impossible to achieve through "business as usual." Zero-based (or clean-sheet) budgeting sounds promising, but in our experience companies use this approach only when they are in dire straits. An alternative is to start by reducing each reporting unit's budget by a fixed percentage (for instance, 10 percent). The resulting tough choices facilitate the redeployment of resources to more valuable opportunities. Finally, challenging budget allocations at a more granular level can help companies reprioritize their investments.[14]

[13] See John T. Horn, Dan P. Lovallo, and S. Patrick Viguerie, "Learning to let go: Making better exit decisions," mckinsey.com/quarterly, May 2006.
[14] For more on reviewing the growth opportunities available across different micromarkets ranging in size from $50 million to $200 million, rather than across business units as a whole, see Mehrdad Baghai, Sven Smit, and Patrick Viguerie, "Is your growth strategy flying blind?" *Harvard Business Review,* May 2009, Volume 87, Number 5, pp. 86–96.

Counter interest biases by making them explicit

Misaligned incentives are a major source of bias. "Silo thinking," in which organizational units defend their own interests, is its most easily detectable manifestation. Furthermore, senior executives sometimes honestly view the goals of a company differently because of their different roles or functional expertise. Heated discussions in which participants seem to see issues from completely different perspectives often reflect the presence of different (and generally unspoken) interest biases.

The truth is that adopting a sufficiently broad (and realistic) definition of "interests," including reputation, career options, and individual preferences, leads to the inescapable conclusion that there will always be conflicts between one manager and another and between individual managers and the company as a whole. Strong decision-making processes explicitly account for diverging interests. For example, if before the time of a decision, strategists formulate precisely the criteria that will and won't be used to evaluate it, they make it more difficult for individual managers to change the terms of the debate to make their preferred actions seem more attractive. Similarly, populating meetings or teams with participants whose interests clash can reduce the likelihood that one set of interests will undermine thoughtful decision making.

Counter social biases by depersonalizing debate

Social biases are sometimes interpreted as corporate politics but in fact are deep-rooted human tendencies. Even when nothing is at stake, we tend to conform to the dominant views of the group we belong to (and of its leader).[15] Many organizations compound these tendencies because of both strong corporate cultures and incentives to conform. An absence of dissent is a strong warning sign. Social biases also are likely to prevail in discussions where everyone in the room knows the views of the ultimate decision maker (and assumes that the leader is unlikely to change her mind).

Countless techniques exist to stimulate debate among executive teams, and many are simple to learn and practice. (For more on promoting debate, see suggestions from Kleiner Perkins' Randy Komisar and Xerox's Anne Mulcahy in "How we do it: Three executives reflect on strategic decision making" on mckinsey.com/quarterly.) But tools per se won't create debate: that is a matter of behavior. Genuine debate requires diversity in the backgrounds and personalities of the decision makers, a climate of trust, and a culture in which discussions are depersonalized.

[15] The Asch conformity experiments, conducted during the 1950s, are a classic example of this dynamic. In the experiments, individuals gave clearly incorrect answers to simple questions after confederates of the experimenter gave the same incorrect answers aloud. See Solomon E. Asch, "Opinions and social pressure," *Scientific American,* 1955, Volume 193, Number 5, pp. 31–35.

Populating meetings or teams with participants whose interests clash can reduce the likelihood that one set of interests will undermine thoughtful decision making

Most crucially, debate calls for senior leaders who genuinely believe in the collective intelligence of a high-caliber management team. Such executives see themselves serving not only as the ultimate decision makers but also as the orchestrators of disciplined decision processes. They shape management teams with the humility to encourage dissent and the self-confidence and mutual trust to practice vigorous debate without damaging personal relationships. We do not suggest that CEOs should become humble listeners who rely solely on the consensus of their teams—that would substitute one simplistic stereotype for another. But we do believe that behavioral strategy will founder without their leadership and role modeling.

Four steps to adopting behavioral strategy

Our readers will probably recognize some of these ideas and tools as techniques they have used in the past. But techniques by themselves will not improve the quality of decisions. Nothing is easier, after all, than orchestrating a perfunctory debate to justify a decision already made (or thought to be made) by the CEO. Leaders who want to shape the decision-making style of their companies must commit themselves to a new path.

1

Decide which decisions warrant the effort

Some executives fear that applying the principles we describe here could be divisive, counterproductive, or simply too time consuming (for more on the dangers of decision paralysis, see the commentary by WPP's Sir Martin Sorrell in "How we do it: Three executives reflect on strategic decision making" on mckinsey.com/quarterly). We share this concern and do not suggest applying these principles to all decisions. Here again, the judicial analogy is instructive. Just as higher standards of process apply in a capital case than in a proceeding before a small-claims court, companies can and should pay special attention to two types of decisions.

The first set consists of rare, one-of-a-kind strategic decisions. Major mergers and acquisitions, "bet the company" investments, and crucial technological choices fall in this category. In most companies, these decisions are made by a small subgroup of the executive team, using an ad hoc, informal, and often iterative process. The second set includes repetitive but high-stakes decisions that shape a company's strategy over time. In most companies, there are generally no more than one or two such crucial processes, such as R&D allocations in a pharmaceutical company, investment decisions in a private-equity firm, or capital expenditure decisions in a utility. Formal processes—often affected by biases—are typically in place to make these decisions.

2

Identify the biases most likely to affect critical decisions

Open discussion of the biases that may be undermining decision making is invaluable. It can be stimulated both by conducting postmortems of past decisions and by observing current decision processes. Are we at risk, in this meeting, of being too action oriented? Do I see someone who thinks he recognizes a pattern but whose choice of analogies seems misleading to me? Are we seeing biases combine to create dysfunctional patterns that, when repeated in an organization, can become cultural traits? For example, is the combination of social and status quo biases creating a culture of consensus-based inertia? This discussion will help surface the biases to which the decision process under review is particularly prone.

3

Select practices and tools to counter the most relevant biases

Companies should select mechanisms that are appropriate to the type of decision at hand, to their culture, and to the decision-making styles of their leaders. For instance, one company we know counters social biases by organizing, as part of its annual planning cycle, a systematic challenge by outsiders to its business units' plans. Another fights pattern-recognition biases by asking managers who present a recommendation to share the raw data supporting it, so other executives in this analytically minded company can try to discern alternative patterns.

If, as you read these lines, you have already thought of three reasons these techniques won't work in your own company's culture, you are probably right. The question is which ones *will*. Adopting behavioral strategy means not only embracing the broad principles set forth above but also selecting and tailoring specific debiasing practices to turn the principles into action.

4

Embed practices in formal processes

By embedding these practices in formal corporate operating procedures (such as capital-investment approval processes or R&D reviews), executives can ensure that such techniques are used with some regularity and not just when the ultimate decision maker feels unusually uncertain about which call to make. One reason it's important to embed these practices in recurring procedures is that everything we know about the tendency toward overconfidence suggests that it is unwise to rely on one's instincts to decide when to rely on one's instincts! Another is that good decision making requires practice as a management team: without regular opportunities, the team will agree in principle on the techniques it should use but lack the experience (and the mutual trust) to use them effectively.

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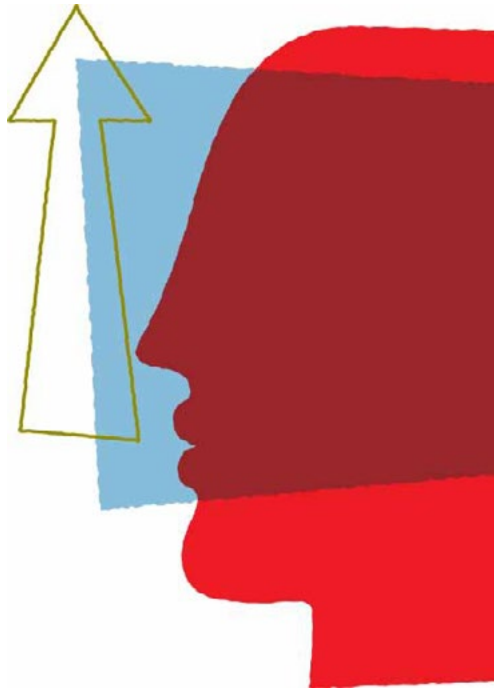
The behavioral-strategy journey requires effort and the commitment of senior leadership, but the payoff—better decisions, not to mention more engaged managers—makes it one of the most valuable strategic investments organizations can make.



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McKinsey Quarterly

A language to discuss biases

Psychologists and behavioral economists have identified dozens of cognitive biases. The typology we present here is not meant to be exhaustive but rather to focus on those biases that occur most frequently and that have the largest impact on business decisions. As these groupings make clear, one of the insidious things about cognitive biases is their close relationship with the rules of thumb and mind-sets that often serve managers well. For example, many a seasoned executive rightly prides herself on pattern-recognition skills cultivated over the years. Similarly, seeking consensus when making a decision is often not a failing but a condition of success. And valuing stability rather than "rocking the boat" or "fixing what ain't broke" is a sound management precept.

This bias typology was prepared by Dan Lovallo and Olivier Sibony.

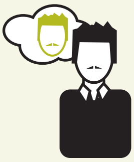
Action-oriented biases

drive us to take action less thoughtfully than we should.

Excessive optimism. The tendency for people to be overoptimistic about the outcome of planned actions, to overestimate the likelihood of positive events, and to underestimate the likelihood of negative ones.

Overconfidence. Overestimating our skill level relative to others', leading us to overestimate our ability to affect future outcomes, take credit for past outcomes, and neglect the role of chance.

Competitor neglect. The tendency to plan without factoring in competitive responses, as if one is playing tennis against a wall, not a live opponent.



Interest biases

arise in the presence of conflicting incentives, including nonmonetary and even purely emotional ones.

Misaligned individual incentives. Incentives for individuals in organizations to adopt views or to seek outcomes favorable to their unit or themselves, at the expense of the overall interest of the company. These self-serving views are often held genuinely, not cynically.

Inappropriate attachments. Emotional attachment of individuals to people or elements of the business (such as legacy products or brands), creating a misalignment of interests.[1]

Misaligned perception of corporate goals. Disagreements (often unspoken) about the hierarchy or relative weight of objectives pursued by the organization and about the trade-offs between them.

[1] Sydney Finkelstein, Jo Whitehead, and Andrew Campbell, *Think Again: Why Good Leaders Make Bad Decisions and How to Keep It fromHappening to You,* Boston: Harvard Business Press, 2008.

Pattern-recognition biases

lead us to recognize patterns even where there are none.

Confirmation bias. The overweighting of evidence consistent with a favored belief, underweighting of evidence against a favored belief, or failure to search impartially for evidence.

Management by example. Generalizing based on examples that are particularly recent or memorable.

False analogies—especially, misleading experiences. Relying on comparisons with situations that are not directly comparable.

Power of storytelling. The tendency to remember and to believe more easily a set of facts when they are presented as part of a coherent story.

Champion bias. The tendency to evaluate a plan or proposal based on the track record of the person presenting it, more than on the facts supporting it.

Stability biases

create a tendency toward inertia in the presence of uncertainty.

Anchoring and insufficient adjustment. Rooting oneself to an initial value, leading to insufficient adjustments of subsequent estimates.

Loss aversion. The tendency to feel losses more acutely than gains of the same amount, making us more risk-averse than a rational calculation would suggest.

Sunk-cost fallacy. Paying attention to historical costs that are not recoverable when considering future courses of action.

Status quo bias. Preference for the status quo in the absence of pressure to change it.

Social biases

arise from the preference for harmony over conflict.

Groupthink. Striving for consensus at the cost of a realistic appraisal of alternative courses of action.

Sunflower management. Tendency for groups to align with the views of their leaders, whether expressed or assumed.

To listen to the authors narrate a more comprehensive presentation of these biases and the ways they can combine to create dysfunctional patterns in corporate cultures, visit mckinsey.com/quarterly.

June 2017

McKinsey Quarterly

Untangling your organization's decision making

Any organization can improve the speed and quality of its decisions by paying more attention to what it's deciding.

by Aaron De Smet, Gerald Lackey, and Leigh M. Weiss

It's the best and worst of times for decision makers. Swelling stockpiles of data, advanced analytics, and intelligent algorithms are providing organizations with powerful new inputs and methods for making all manner of decisions. Corporate leaders also are much more aware today than they were 20 years ago of the cognitive biases—anchoring, loss aversion, confirmation bias, and many more—that undermine decision making without our knowing it. Some have already created formal processes—checklists, devil's advocates, competing analytic teams, and the like—to shake up the debate and create healthier decision-making dynamics.

Now for the bad news. In many large global companies, growing organizational complexity, anchored in strong product, functional, and regional axes, has clouded accountabilities. That means leaders are less able to delegate decisions cleanly, and the number of decision makers has risen. The reduced cost of communications brought on by the digital age has compounded matters by bringing more people into the flow via email, Slack, and internal knowledge-sharing platforms, without clarifying decision-making authority. The result is too many meetings and email threads with too little high-quality dialogue as executives ricochet between boredom and disengagement, paralysis, and anxiety (Exhibit 1). All this is a recipe for poor decisions: 72 percent of senior-executive respondents to a McKinsey survey said they thought bad strategic decisions either were about as frequent as good ones or were the prevailing norm in their organization.

Exhibit 1

Growing organizational complexity and proliferating digital communications are a recipe for poor decisions.

Disengagement
Hearing a presentation for the hundredth time

Paralysis
Stymied by too much data

Anxiety
The stakes are too high

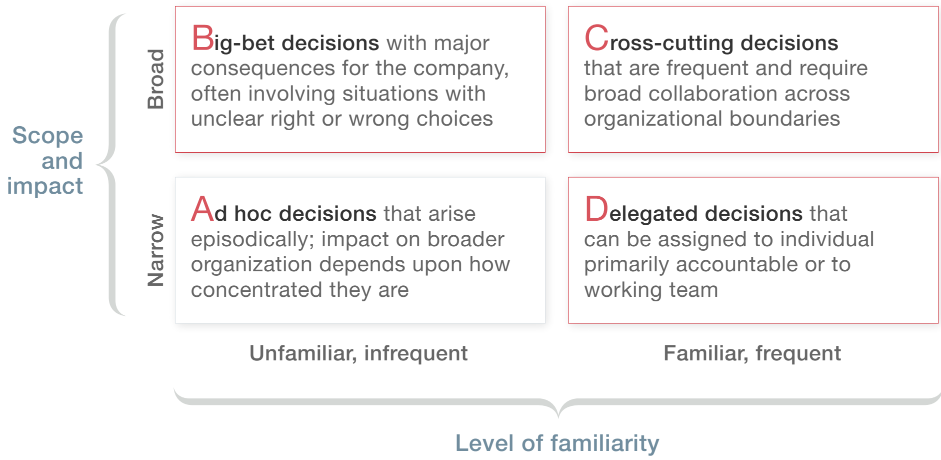
The ultimate solution for many organizations looking to untangle their decision making is to become flatter and more agile, with decision authority and accountability going hand in hand. High-flying technology companies such as Google and Spotify are frequently the poster children for this approach, but it has also been adapted by more traditional ones such as ING (for more, see our recent *McKinsey Quarterly* interview "ING's agile transformation," on McKinsey.com). As we've described elsewhere,[1] agile organization models get decision making into the right hands, are faster in reacting to (or anticipating) shifts in the business environment, and often become magnets for top talent, who prefer working at companies with fewer layers of management and greater empowerment.

As we've worked with organizations seeking to become more agile, we've found that it's possible to accelerate the improvement of decision making through the simple steps of categorizing the type of decision that's being made and tailoring your approach accordingly. In our work, we've observed four types of decisions (Exhibit 2):

[1] See Wouter Aghina, Aaron De Smet, and Kirsten Weerda, "Agility: It rhymes with stability," *McKinsey Quarterly*, December 2015, McKinsey.com.

Exhibit 2

The ABCDs of categorizing decisions.



- Big-bet decisions. These infrequent and high-risk decisions have the potential to shape the future of the company.

- Cross-cutting decisions. In these frequent and high-risk decisions, a series of small, interconnected decisions are made by different groups as part of a collaborative, end-to-end decision process.

- Delegated decisions. These frequent and low-risk decisions are effectively handled by an individual or working team, with limited input from others.

- Ad hoc decisions. The organization's infrequent, low-stakes decisions are deliberately ignored in this article, in order to sharpen our focus on the other three areas, where organizational ambiguity is most likely to undermine decision-making effectiveness.

These decision categories often get overlooked, in our experience, because organizational complexity, murky accountabilities, and information overload have conspired to create messy decision-making processes in many companies. In this article, we'll describe how to vary your decision-making methods according to the circumstances. We'll also offer some tools that individuals can use to pinpoint problems in the moment and to take corrective action that should improve both the decision in question and, over time, the organization's decision-making norms.

Before we begin, we should emphasize that even though the examples we describe focus on enterprise-level decisions, the application of this framework will depend on the reader's perspective and location in the organization. For example, what might be a delegated decision for the enterprise as a whole could be a big-bet decision for an individual business unit. Regardless, any fundamental change in decision-making culture needs to involve the senior leaders in the organization or business unit. The top team will decide what decisions are big bets, where to appoint process leaders for cross-cutting decisions, and to whom to delegate. Senior executives also serve the critical functions of role-modeling a culture of collaboration and of making sure junior leaders take ownership of the delegated decisions.

BIG BETS

Bet-the-company decisions—from major acquisitions to game-changing capital investments—are inherently the most risky. Efforts to mitigate the impact of cognitive biases on decision making have, rightly, often focused on big bets. And that's not the only special attention big bets need. In our experience, steps such as these are invaluable for big bets:

- Appoint an executive sponsor. Each initiative should have a sponsor, who will work with a project lead to frame the important decisions for senior leaders to weigh in on—starting with a clear, one-sentence problem statement.

- Break things down, and connect them up. Large, complex decisions often have multiple parts; you should explicitly break them down into bite-size chunks, with decision meetings at each stage. Big bets also frequently have interdependencies with other decisions. To avoid unintended consequences, step back to connect the dots.

- Deploy a standard decision-making approach. The most important way to get big-bet decisions right is to have the right kind of interaction and discussion, including quality debate, competing scenarios, and devil's advocates. Critical requirements are to create a clear agenda that focuses on debating the solution (instead of endlessly elaborating the problem), to require robust prework, and to assemble the right people, with diverse perspectives.

- Move faster without losing commitment. Fast-but-good decision making also requires bringing the available facts to the table and committing to the outcome of the decision. Executives have to get comfortable living with imperfect data and being clear about what "good enough" looks like. Then, once a decision is made, they have to be willing to commit to it and take a gamble, even if they were opposed during the debate. Make sure, at the conclusion of every meeting, that it is clear who will communicate the decision and who owns the actions to begin carrying it out.

An example of a company that does much of this really well is a semiconductor company that believes so much in the importance of getting big bets right that it built a whole management system around decision making. The company never has more than one person accountable for decisions, and it has a standard set of facts that need to be brought into any meeting where a decision is to be made (such as a problem statement, recommendation, net present value, risks, and alternatives). If this information isn't provided, then a discussion is not even entertained. The CEO leads by example, and to date, the company has a very good track record of investment performance and industry-changing moves.

It's also important to develop tracking and feedback mechanisms to judge the success of decisions and, as needed, to course correct for both the decision and the decision-making process. One technique a regional energy provider uses is to create a one-page self-evaluation tool that allows each member of the team to assess how effectively decisions are being made and how well the team is adhering to its norms. Members of key decision-making bodies complete such evaluations at regular intervals (after every fifth or tenth meeting). Decision makers also agree, before leaving a meeting where a decision has been made, how they will track project success, and they set a follow-up date to review progress against expectations.

Big-bet decisions often are easy to recognize, but not always (Exhibit 3). Sometimes a series of decisions that might appear small in isolation represent a big bet when taken as a whole. A global technology company we know missed several opportunities that it could have seized through big-bet investments, because it was making technology-development decisions independently across each of its product lines, which reduced its ability to recognize far-reaching shifts in the industry. The solution can be as simple as a mechanism for periodically categorizing important decisions that are being made across the organization, looking for patterns, and then deciding whether it's worthwhile to convene a big-bet-style process with executive sponsorship. None of this is possible, though, if companies aren't in the habit of isolating major bets and paying them special attention.

CROSS-CUTTING DECISIONS

Far more frequent than big-bet decisions are cross-cutting ones—think pricing, sales, and operations planning processes or new-product launches—that demand input from a wide range of constituents. Collaborative efforts such as these are not actually single-point decisions, but instead comprise a series of decisions made over time by different groups as part of an end-to-end process. The challenge is not the decisions themselves but rather

Exhibit 3

A belated heads-up means you are not recognizing big bets.

The problem: Missing your "Bs" (big bets)

Symptoms

Senior leaders are surprised when they hear about the decision

Decision has big implications for the organization, but some relevant senior leaders are not in the room

Example

Wealth-management company where business-unit leaders made significant, independent commitments of capital in M&A decisions, constraining options for rest of business

Fixing the problem

Questions to ask

What are the implications for the organization?

Would someone higher up want to have input into this decision?

Mind-set to overcome

"I can make any decision that affects my part of the business"

the choreography needed to bring multiple parties together to provide the right input, at the right time, without breeding bureaucracy that slows down the process and can diminish the decision quality. This is why the common advice to focus on "who has the decision" (or, "the D") isn't the right starting point; you should worry more about where the key points of collaboration and coordination are.

It's easy to err by having too little or too much choreography. For an example of the former, consider the global pension fund that found itself in a major cash crunch because of uncoordinated decision making and limited transparency across its various business units. A perfect storm erupted when different business units' decisions simultaneously increased the demand for cash while reducing its supply. In contrast, a specialty-chemicals company experienced the pain of excess choreography when it opened membership on each of its six governance committees to all senior leaders without clarifying the actual decision makers. All participants felt they had a right (and the need) to express an opinion on everything, even where they had little knowledge or expertise. The purpose of the meetings morphed into information sharing and unstructured debate, which stymied productive action (Exhibit 4).

Exhibit 4

Too many cooks get involved in the absence of processes for cross-cutting decisions.

The problem: Treating a "C" (cross-cutting decision) as a "B" (big bet)

Symptoms	Example
Decisions have major implications for parts of business whose stakeholders aren't involved, resulting in poor decisions Important decisions get slowed down by largely unnecessary committee meetings and approvals	Specialty-chemicals company where every R&D stage-gate decision went to executive team for review, though the team lacked the expertise to make a reasoned call

Fixing the problem

Questions to ask	Mind-set to overcome
Are we making this same type of decision on a regular basis? Do we have the relevant stakeholders with expertise to inform the decision involved?	"This is an important decision that can't be made without senior-most approval, even though we make these decisions regularly"

Whichever end of the spectrum a company is on with cross-cutting decisions, the solution is likely to be similar: defining roles and decision rights along each step of the process. That's what the specialty-chemicals company did. Similarly, the pension fund identified its CFO as the key decision maker in a host of cash-focused decisions, and then it mapped out the decision rights and steps in each of the contributing processes. For most companies seeking enhanced coordination, priorities include:

- Map out the decision-making process, and then pressure-test it. Identify decisions that involve a cross-cutting group of leaders, and work with the stakeholders of each to agree on what the main steps in the process entail. Lay out a simple, plain-English playbook for the process to define the calendar, cadence, handoffs, and decisions. Too often, companies find themselves building complex process diagrams that are rarely read or used beyond the team that created them. Keep it simple.

- Run water through the pipes. Then work through a set of real-life scenarios to pressure-test the system in collaboration with the people who will be running the process. We call this process "running water through the pipes," because the first several times you do it, you will find where the "leaks" are. Then you can improve the process, train people to work within (and, when necessary, around) it, and confront, when the stakes are relatively low, leadership tensions or stresses in organizational dynamics.

- Establish governance and decision-making bodies. Limit the number of decision-making bodies, and clarify for each its mandate, standing membership, roles (decision makers or critical "informers"), decision-making protocols, key points of collaboration, and standing agenda. Emphasize to the members that committees are not meetings but decision-making bodies, and they can make decisions outside of their standard meeting times. Encourage them to be flexible about when and where they make decisions, and to focus always on accelerating action.

- Create shared objectives, metrics, and collaboration targets. These will help the persons involved feel responsible not just for their individual contributions in the process, but also for the process's overall effectiveness. Team members should be encouraged to regularly seek improvements in the underlying process that is giving rise to their decisions.

Getting effective at cross-cutting decision making can be a great way to tackle other organizational problems, such as siloed working (Exhibit 5). Take, for example, a global finance company with a matrix of operations across markets and regions that struggled with cross-business-unit decision

Exhibit 5

When you are locked in silos, you are unlikely to collaborate effectively on cross-cutting decisions.

The problem: Treating a "C" (cross-cutting decision) as a "D" (delegated)

Symptoms

Decisions create value for 1 part of business at the expense of others or the entire enterprise

Executives feel they don't know the organization-wide strategy or what different parts of business are doing

Example

Financial company where 1 business unit changed its product without considering impact on profit and loss for other product business units

Fixing the problem

Questions to ask

Who are the stakeholders in this decision?

How do we facilitate an open and rapid flow of information?

Mind-set to overcome

"My obligation is to my part of the organization, not the enterprise as a whole" making. Product launches often cannibalized the products of other market groups. When the revenue shifts associated with one such decision caught the attention of senior management, company leaders formalized a new council for senior executives to come together and make several types of cross-cutting decisions, which yielded significant benefits.

DELEGATED DECISIONS

Delegated decisions are far narrower in scope than big-bet decisions or cross-cutting ones. They are frequent and relatively routine elements of day-to-day management, typically in areas such as hiring, marketing, and purchasing. The value at stake for delegated decisions is in the multiplier effect they can have because of the frequency of their occurrence across the organization. Placing the responsibility for these decisions in the hands of those closest to the work typically delivers faster, better, and more efficiently executed decisions, while also enhancing engagement and accountability at all levels of the organization.

In today's world, there is the added complexity that many decisions (or parts of them) can be "delegated" to smart algorithms enabled by artificial intelligence. Identifying the parts of your decisions that can be entrusted to intelligent machines will speed up decisions and create greater consistency and transparency, but it requires setting clear thresholds for when those systems should escalate to a person, as well as being clear with people about how to leverage the tools effectively.

It's essential to establish clarity around roles and responsibilities in order to craft a smooth-running system of delegated decision making (Exhibit 6). A renewable-energy company we know took this task seriously when undergoing a major reorganization that streamlined its senior management and drove decisions further down in the organization. The company developed a 30-minute "role card" conversation for each manager to have with his or her direct reports. As part of this conversation, managers explicitly laid out the decision rights and accountability metrics for each direct report. This approach allowed the company's leaders to decentralize their decision making while also ensuring that accountability and transparency were in place. Such role clarity enables easier navigation, speeds up decision making, and makes it more customer focused. Companies may find it useful to take some of the following steps to reorganize decision-making power and establish transparency in their organization:

Exhibit 6

Drawn-out and complicated processes often mean more delegating is needed.

The problem: Treating a "D" (delegated decision) as a "C" (cross-cutting)

Symptoms	Example
Decisions that should be quick seem to take forever and involve more alignment than needed Decisions become unnecessarily complex because of efforts to incorporate all stakeholder input	Energy company where changes to HR or finance policies were governed by executive committee instead of delegated to head of HR or CFO

Fixing the problem

Questions to ask	Mind-set to overcome
Is there a single role that could make this decision (eg, it's part of the job description)? Who needs to provide input but has no "vote"?	"Delegating is risky; we don't just let people collect input from others and then decide whatever they want"

- Delegate more decisions. To start delegating decisions today, make a list of the top 20 regularly occurring decisions. Take the first decision and ask three questions: (1) Is this a reversible decision? (2) Does one of my direct reports have the capability to make this decision? (3) Can I hold that person accountable for making the decision? If the answer to these questions is yes, then delegate the decision. Continue down your list of decisions until you are only making decisions for which there is one shot to get it right and you alone possess the capabilities or accountability. The role-modeling of senior leaders is invaluable, but they may be reluctant. Reassure them (and yourself) by creating transparency through good performance dashboards, scorecards, and key performance indicators (KPIs), and by linking metrics back to individual performance reviews.

- Avoid overlap of decision rights. Doubling up decision responsibility across management levels or dimensions of the reporting matrix only leads to confusion and stalemates. Employees perform better when they have explicit authority and receive the necessary training to tackle problems on their own. Although it may feel awkward, leaders should be explicit with their teams about when decisions are being fully delegated and when the leaders want input but need to maintain final decision rights.

- Establish a clear escalation path. Set thresholds for decisions that require approval (for example, spending above a certain amount), and lay out a specific protocol for the rare occasion when a decision must be kicked up the ladder. This helps mitigate risk and keeps things moving briskly.

- Don't let people abdicate. One of the key challenges in delegating decisions is actually getting people to take ownership of the decisions. People will often succumb to escalating decisions to avoid personal risk; leaders need to play a strong role in encouraging personal ownership, even (and especially) when a bad call is made.

This last point deserves elaboration: although greater efficiency comes with delegated decision making, companies can never completely eliminate mistakes, and it's inevitable that a decision here or there will end badly. What executives must avoid in this situation is succumbing to the temptation to yank back control (Exhibit 7). One CEO at a Fortune 100 company learned this lesson the hard way. For many years, her company had worked under a decentralized decision-making framework where business-unit leaders could sign off on many large and small deals, including M&A. Financial underperformance and the looming risk of going out of business during a severe market downturn led the CEO to pull back control and centralize virtually all decision making. The result was better cost control at the expense of swift decision making. After several big M&A deals came and

Exhibit 7

Top-heavy processes often mean more delegating is needed.

The problem: Treating a "D" (delegated decision) as a "B" (big bet)

Symptoms	Example
Senior executives (want to) control decisions that should rightfully be made lower in the organization Escalation of decisions to top of organization is common	High-tech company that required CEO to sign off on all new hires at any level of the organization

Fixing the problem

Questions to ask	Mind-sets to overcome
What is the lowest level of accountability at which this decision could be made? What skills and capabilities are needed to make this decision?	"I need to be involved in all decisions" (senior executive) "I can't make a decision on my own, because that's not how we do things here"

went because the organization was too slow to act, the CEO decided she had to decentralize decisions again. This time, she reinforced the decentralized system with greater leadership accountability and transparency.

Instead of pulling back decision power after a slipup, hold people accountable for the decision, and coach them to avoid repeating the misstep. Similarly, in all but the rarest of cases, leaders should resist weighing in on a decision kicked up to them during a logjam. From the start, senior leaders should collectively agree on escalation protocols and stick with them to create consistency throughout the organization. This means, when necessary, that leaders must vigilantly reinforce the structure by sending decisions back with clear guidance on where the leader expects the decision to be made and by whom. If signs of congestion or dysfunction appear, leaders should reexamine the decision-making structure to make sure alignment, processes, and accountability are optimally arranged.

None of this is rocket science. Indeed, the first decision-making step Peter Drucker advanced in "The effective decision," a 1967 *Harvard Business Review* article, was "classifying the problem." Yet we're struck, again and again, by how few large organizations have simple systems in place to make sure decisions are categorized so that they can be made by the right people in the right way at the right time. Interestingly, Drucker's classification system focused on how generic or exceptional the problem was, as opposed to questions about the decision's magnitude, potential for delegation, or cross-cutting nature. That's not because Drucker was blind to these issues; in other writing, he strongly advocated decentralizing and delegating decision making to the degree possible. We'd argue, though, that today's organizational complexity and rapid-fire digital communications have created considerably more ambiguity about decision-making authority than was prevalent 50 years ago. Organizations haven't kept up. That's why the path to better decision making need not be long and complicated. It's simply a matter of untangling the crossed web of accountability, one decision at a time. Q

Aaron De Smet is a senior partner in McKinsey's Houston office, **Gerald Lackey** is an expert in the Washington, DC, office, and **Leigh Weiss** is a senior expert in the Boston office.

A case study in combating bias

Following several disappointing investments, the German electric utility RWE overhauled its decision-making processes. Learn how from the CFO who spearheaded the effort.

The *Quarterly*: *Tell us a bit about the circumstances that motivated RWE's management to undertake a broad debiasing operation.*

Bernhard Günther: In the second half of the last decade, we spent more than €10 billion on big capital-expenditure programs and acquisitions in conventional power plants. In the business cases underlying these decisions, we were betting on the assumptions of ever-rising commodity prices, ever-rising power prices. We were not alone in our industry in hitting a kind of investment peak at that time. What we and most other peers totally under-estimated was the turnaround in public sentiment toward conventional power generation—for example, the green transformation of the German energy system, and the technological progress in renewable generation and related production costs. These factors went in a completely opposite direction compared to our scenarios.

Conventional power generation in continental Europe went through the deepest crisis the industry has ever seen. This ultimately led to the split of the two biggest German players in the industry, E.ON and RWE. Both companies separated their ailing conventional power-generation businesses from the rest of the company.

The *Quarterly*: *Was it difficult to convince members of the executive and supervisory boards to scrutinize your decision-making practices?*

Bernhard Günther: Actually, it was the supervisory board asking, "Where has the shareholders' money gone?" and we in the executive board wanted to learn our lessons from this experience as well. So we embarked on a postmortem analysis to understand what went wrong and why, by looking at a sample of these €10 billion investments. We asked ourselves, "Is there anything we could have done differently, and if so, how can we learn from this in the future?" The spirit of it was not about shaming and blaming, but about learning from our own mistakes.

The *Quarterly*: *What were the main contributing factors that you identified in your investigation?*

Bernhard Günther: There were a few outright areas of managerial underperformance such as some time and cost overruns on the €10 billion investments, totally unrelated to external factors. There were also exogenous factors that were not in our base-case assumption but that should have been within our solution space—the most obvious being the political intent to push renewables into the market, which was publicly known at the time our investment decisions were made. There was also at least one unforeseeable factor—the Fukushima disaster. The German government reacted by rushing into a sudden exit from nuclear-power generation. Roughly half of the nuclear plants were switched off immediately, significantly shortening the economic lifetime of the remaining plants. But even if you discount for Fukushima, I think the ultimate end game wouldn't have looked much different from today's perspective; it just speeded the whole thing up.

The *Quarterly*: *As you analyzed the decision-making dynamics at work, what biases did you start to see?*

Bernhard Günther: What became obvious is that we had fallen victim to a number of cognitive biases in combination. We could see that status quo and confirmation biases had led us to assume the world would always be what it used to be. Beyond that, we neglected to heed the wisdom of portfolio theory that you shouldn't lay all your eggs in one basket. We not only laid them in the same basket, but also within a very short period of time—the last billion was committed before the construction period of the first billion had been finalized. If we had stretched this whole €10 billion program out over a longer period, say 10 or 15 years, we might still have lost maybe €1 billion or €2 billion but not the amount we incurred later.

We also saw champion and sunflower biases, which are about hierarchical patterns and vertical power distance. Depending on the way you organize decision processes, when the boss speaks up first, the likelihood that anybody who's not the boss will speak up with a dissenting opinion is much lower than if you, for example, have a conscious rule that the bigwigs in the hierarchy are the ones to speak up last, and you listen to all the other evidence before their opinion is offered.

And we certainly overestimated our own abilities to deliver, due to a good dose of action-oriented biases like overconfidence and excessive optimism. Our industry, like many other capital-intensive ones, has had boom and bust cycles in investments. We embarked on a huge investment program with a whole generation of managers who hadn't built a single power plant in their professional lives; there were just a few people left who could really remember how big investments were done. So we did something that the industry, by and large, hadn't been doing on a large scale for 20 years.

The *Quarterly*: *On the sunflower bias, how far down in the organization do you think that went? Were people having a hard time getting past their superiors' views just on the executive level, or all the way down?*

Bernhard Günther: Our investigation revealed that it went much farther down, to almost all levels of our organizational hierarchy. For example, there was a feeling within the rank and file who produced the investment valuations for major decisions that certain scenarios were not desired—that you exposed yourself to the risk of being branded an eternal naysayer, or worse, when you pushed for more pessimistic scenarios. People knew that there were no debiasing mechanisms upstairs, so they would have no champion too if they were to suggest, for example, that if we looked at a "brilliant" new investment opportunity from a different angle, it might not look that brilliant anymore.

The *Quarterly*: *So, what kind of countermeasures did you put in place to tackle these cultural issues?*

Bernhard Günther: We started a cultural-change program early on, with the arrival of our new CEO, to address our need for a different management mind-set in light of an increasingly uncertain future. A big component of that was mindfulness—becoming aware of not only your own cognitive patterns, but also the likely ones of the people you work with. We also sought to embed this awareness in practical aspects of our process. For example, we've now made it mandatory to list the debiasing techniques that were applied as part of any major proposal that is put before us as a board.

It was equally important for us to start to create an atmosphere in which people are comfortable with a certain degree of conflict, where there is an obligation to dissent. This is not something I would say is part of the natural DNA of many institutions, including ours. We've found that we have to push it forward and safeguard it, because as soon as hierarchy prevails, it can be easily discouraged.

So, for example, when making big decisions, we now appoint a devil's advocate—someone who has no personal stake in the decision and is senior enough in the hierarchy to be as independent as possible, usually a level below the executive board. And nobody blames the devil's advocate for making the negative case because it's not necessary for them to be personally convinced; it's about making the strongest case possible. People see that constructive tension brings us further than universal consent.

The *Quarterly*: *How did you roll all this out?*

Bernhard Günther: There were two areas of focus. First, over a period of two years, we sent the top 300 of our company's management to a two-week course, which we had self-assembled with external experts. The main thrust of this program was self-awareness: being more open to dissent, more open to a certain amount of controlled risk taking, more agile, as with rapid prototyping, and so forth.

RAPID REFLECTIONS
FROM BERNHARD GÜNTHER

1 **IN YOUR EXPERIENCE, WHAT PIECE OF COMMON LEADERSHIP ADVICE IS WRONG OR MISLEADING?**

People development based on weaknesses—or gaps versus "ideal candidate" profile—instead of building on strengths

2 **WHICH HISTORICAL FIGURES DO YOU ADMIRE THE MOST?**

Nelson Mandela and Martin Luther King Jr.

3 **WHAT'S THE BEST BOOK YOU'VE READ IN THE PAST YEAR?**

Freedom, by Jonathan Franzen (fiction)

You! The Positive Force in Change: Leveraging Insights from Neuroscience and Positive Psychology, by Eileen Rogers and Nick van Dam (nonfiction)

4 **WHAT SKILL DO YOU THINK IS MOST UNDERVALUED IN LEADERS TODAY?**

Listening

Then we also launched a training program for managers and experts, especially those involved in project work—for example, the financial controllers that have to run the models for big investment decisions. This was a combination of a training course, some desktop training you could do on your own, and some distributed materials.

This program explicitly focused on debiasing. It started with these typical examples where you can show everybody how easily we fall into those cognitive traps, framing it not as a personal defect but as something that's just there. Secondly, it emphasized that debiasing can be done much more easily within a group, because it's a collective, conscious effort. And not some kind of empty ritual either. We taught very specific things that people could apply in their daily practices. For example, you can do a kind of premortem analysis and ask your team, "Imagine we are five years into the future, and this whole project we're deciding on today has turned out to be a complete disaster. What could have happened in the meantime? What could have gone wrong?" This is something that we are now doing regularly on big projects, especially when there are uncertain environmental factors—whether macroeconomic, technological, ecological, or political.

The *Quarterly*: *Could you tell us about an example or two where you made a different decision as the result of debiasing practice, where it went the other way from what you initially thought was the right answer?*

Bernhard Günther: Two examples immediately come to my mind. The first one came up in the middle of 2015, when it became obvious that our company was in a strategic deadlock with the power-generation business—the cash cow of the company for years but now with a broken business model. There was a growing awareness among senior management that trying to cure the crisis with yet another round of cost cutting might not be good enough, that we needed to consider more radical strategic options. We established a red team and a blue team to come up with different proposals, one staffed internally and one with externals. We wanted an unbiased view from the outside, from people who were not part of our company or industry; in this case, we brought in external people with backgrounds in investment banking.

The internal team came up with the kind of solution that I think everybody was initially leaning toward, which was more incremental. And the external team came up with a more disruptive solution. But because it was consciously pitched as an independent view, everybody on the board took their time to seriously consider it with an open mind. It planted the seedling of the strategy that we adopted to split the company into two parts, which now, a good year later, has successfully concluded with the IPO of Innogy. If we hadn't taken this approach, maybe months later or years later, somebody would have come up with a similar idea, but it wouldn't have happened that fast, with that kind of momentum.

The second example is a recent potential investment project in renewable energy that carried high reputational value for us, so there were emotional issues attached to winning the project. We were bidding for a wind park that was to be built, and the lowest bidder wins by offering the lowest electricity price. We knew it would be a very competitive auction for that project, and we had already decided in the run up to the decision making that we wanted to have a devil's advocate involved.

We had the project team make the case first in the board meeting. Then we had the devil's advocate put forward analysis of the risk–return trade-offs. All of this was in written form, so everybody had to read it before the meeting. This certainly helped our discussion a lot and made it much easier to have a nonemotional debate around the critical issues. And we came out of it with a different and I think better decision than we would have if we had just taken the proposal of our internal project team at face value.

The *Quarterly*: *Now that these decision-making changes have taken hold, how do you see things running differently in the organization?*

Bernhard Günther: Looking back at where we were three or four years ago, I'd say that this practice of awareness and debiasing has now become almost a part of our corporate decision-making DNA. But it's something you have to constantly force yourself to practice again and again, because everyone at some point asks, "Do we really need to do it? Can't we just decide?" It's a very time-intensive process, which should be utilized only for the most important decisions of strategic relevance. About 30 percent of our board's decisions fall into this category—for example, major resource-allocation decisions—and it's similar elsewhere in the company.

Also, people's general awareness of the complex set of issues around cognitive biases has grown dramatically. Before this, things easily degenerated into blaming exercises going both ways. The naysayers were critiquing the others for wanting to push their pet projects. And the people promoting these projects were saying that the naysayers were just narrow-minded financial controllers who were destroying the company by eternally killing good business ideas. But now there's more mutual respect for these different roles that are needed to ultimately come up with as good a decision outcome as possible. It's not just about debiasing; it's given us a common language.

It's now routine for somebody to say in a meeting, "I think we need some debiasing here." And then everybody can agree to this without any need to get emotional. When in doubt, we just go through the process.

The *Quarterly*: *Do you have any recommendations for other senior leaders who might be reading this interview?*

Bernhard Günther: I think when you read about these issues, it can seem a bit esoteric. You might say, "Well, maybe it's just their problem, but not mine." I think everyone should just do it; just start with it even on a pilot basis. You don't have to start rolling it out across 1,000 people. You can start with your own board, with a few test examples, and see if you think it helps you. But if you do it, you have to do it right; you have to be serious about it. Looking back, there were a few key success factors for us. For one, top management has to set an example. That's true of any kind of change, not just debiasing. If it's not modeled at the very top, it's unlikely to happen further down the hierarchy. Second, everyone has to be open to these ideas or it can be difficult to really make progress. At first glance, many of the tools might seem trivial to some, but we found them to have a very profound effect. Q

Bernhard Günther joined RWE in 1999 and served as the company's chief financial officer from 2013 until the 2016 spin-off and IPO of Innogy, where he is now CFO. This interview was conducted by **Sven Heiligtag,** a partner in McKinsey's Hamburg office, and **Allen Webb,** *McKinsey Quarterly*'s editor in chief, who is based in the Seattle office.

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