

Sydney Finkelstein: On Bad Decisions

By David Creelman

Wisdom has a lot to do with avoiding decisions that look attractive, but will turn out badly. If you have been out late at a party and on the way home your friend says, “I know where we can still get one more drink!” well, that sure sounds attractive but the wise decision is to refrain.

Dr. Sydney Finkelstein, lead author of [*Think Again: Why good leaders make bad decisions and how to keep it from happening to you*](#) is interested in how we can figure out which decisions are at risk of being the really bad ones. If we understand the psychological processes that guide decision making, and look at real examples of where decisions have gone bad, then we can identify red flags to watch for. These red flags are the banners of wisdom.

How Humans Make Decisions

As we get into the topic of decision making we once again have to kill off the rational choice model beloved by economists. Wise management thinkers like Henry Mintzberg, James March and Karl Weick have long argued that the rational choice model doesn't reflect reality. It's important to understand the major mechanisms that underlie real decision making.

Finkelstein explains, “We don't list a bunch of alternatives, identify the pros and cons, weight them and then identify the best ones. That hardly ever happens in real life. What we do is make **one**

plan at a time – usually without discussion, perhaps even without conscious awareness that we are making a decision. We just take the first reasonable option and do it until it clearly isn't working”

“If a marketing manager has to place ads in some media, she might well just place internet banner ads because that is what she did last time and it worked well, or she read something about it and it seemed reasonable, or it she felt it was the cool thing to do,” says Finkelstein. “She'll keep doing it until it clearly is not working.”

Young and not yet wise MBAs critique this kind of ‘irrational’ behaviour but humans operate the way we do for a reason.

“We can't take forever to make decisions,” says Finkelstein, “Imagine if we had to debate the pros and cons of everything. The one plan at a time model works pretty well—at least it does most of time.”

It's that last phrase “most of the time” that chills the blood because just one really big mistake can be enough to kill a company.

“There's another thing I want you to understand about the brain,” Finkelstein continues. “Anytime we do anything we file it away and it's tagged with a memory of success or failure. I call it **emotional tagging**. When faced with a

situation we almost always without thinking make our decision based on those emotional tags.”

Again this makes sense, of course we’ll do what worked for us in the past: it’s the “without thinking” part that you need to watch out for.

“If you look at RBS (the Royal Bank of Scotland)—which is such a disaster that they may be taken over by the British government—their really bad decision was the acquisition of ABN Amro. RBS had made previous acquisitions which had gone well and had got accolades in the press for their great work. So they went out of their way to repeat that experience and chased down the ABN Amro acquisition without proper caution.”

If only RBS had noted some kind of red flag which warned them that their decision making process was at risk of making a serious error then they might have escaped their nasty fate.

Four Red Flags

There are all kinds of biases and shortcuts that underlie human decision making. However, to list dozens of possible thinking errors isn’t helpful. Finkelstein looked at a host of business decisions that went bad and found four red flags that, if noticed, should make a company *think again* about their decision.

Red Flag Condition 1: Inappropriate Attachments

People are naturally attached to certain people, places or things; sometimes those attachments lead you down the wrong path.

“Look at Yahoo!’s founder Jerry Yang,” says Finkelstein. “He had a chance to sell his company to Microsoft last year for an incredible price—but refused. Stock prices have tanked since then and if you add up the numbers it was something like a 30 billion dollar mistake. Yang was so emotionally attached to his company, and so hated the “evil empire” (Microsoft) that he made an extraordinarily bad decision.”

Red Flag Condition 2: Inappropriate Self-Interest

It’s not surprising that people make decisions that are bad for the organization but good for them. There are lots of examples from Wall Street. John Thain, former CEO of Merrill Lynch and now part of Bank of America, recently tried to get a big bonus for himself even though the company had received TARP funding from the government, and had seen B of A’s stock price come tumbling down.

“The most interesting part of the self-interest story is that a lot of research suggests that most of the time people who are behaving in a self-interested manner are not aware of it and would be offended if you suggested they were,” says Finkelstein.

So even people who feel they are operating with high integrity may make decisions which hurt the organization because they fail to detect they are operating out of self-interest.

Red Flag Condition 3: Misleading Pre-judgements

“There is a very unfortunate example of pre-judgement in the hurricane Katrina story,” recounts Finkelstein, “The

Department of Homeland Security is responsible for threats to the country, natural or terrorist. The person in charge of the response to Katrina was a retired 4-star general who, in the very first hours, made a pre-judgement that Katrina was not very different from the hurricanes that hit Florida on a regular basis. He was not able to recognize just potentially how severe this could be. As he monitored the situation he looked for data that were consistent with this pre-judgement and disregarded those data-points that challenged it. That is why the Federal Government response was so poor.”

Red Flag Condition 4: Misleading Experiences

Experience is the best teacher—usually. Unfortunately, it was a misleading experience that helped cause the demise of Lehman Brothers.

Finkelstein explains, “Richard Fuld, Lehman Brothers’ CEO, had managed Lehman through the collapse of the Long Term Capital Management hedge fund in 1998. At that time many people were concerned about the collapse of the banking system, much as it has come to pass now. Fuld is credited with acting with care and speed to get Lehman through that crisis. As a result, Fuld was confident that he could handle this crisis and didn’t try to sell the company until the last minute when it was too late.”

Operationalizing Wisdom

Finkelstein devotes a lot of his book on the practical things you can realistically do to notice and react to these four red flags. But let me just point out a simple way to operationalize wisdom: write these four red flags on a little card and stick it on your wall. Next time you are

involved in a big decision take a look at the card and ask yourself if any of the red flags apply. If they do, think again.

We can’t avoid all mistakes and we don’t have the time to over-analyse every decision. But if you know that these four areas represent the most likely causes of bad decisions, then you are in a position to catch yourself before it’s too late.

Note: The people who are responsible for overseeing the biggest decisions are the board. If you know someone on a board send them this paper; better yet, buy them a copy of Syd’s book.

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